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NOMINATION OF RICHARD C. BREEDEN

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

THE NOMINATION OF

RICHARD C. BREEDEN, OF VIRGINIA, TO BE A MEMBER OF THE SECURITIES AND EXCHANGE COMMISSION FOR THE TERM EXPIRING JUNE 5, 1993, VICE CHARLES C. COX, TERM EXPIRED

SEPTEMBER 14, 1989

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THURSDAY, SEPTEMBER 14, 1989

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m., in room SD-538 of the Dirksen Senate Office Building, Senator Donald W. Riegle (chairman of the committee) presiding.

Present: Senators Riegle, Dixon, Shelby, D'Amato, Bond, Wirth, Gramm, Dodd, Bryan, Sasser, Heinz, Sanford, Graham, Pressler, and Kassebaum.

OPENING REMARKS OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

We are going to start right on time this morning. We have a vote that is scheduled to commence at 10:30, so we will have an interruption. We want to minimize that interruption and have a maximum amount of time available this morning with the nominee.

Accompanying Richard Breeden is our esteemed colleague from New Hampshire, Warren Rudman, who is here. I am told that Senators Robb and Warner may also be arriving to make some supportive introductory comments. I will have a statement that I will make at an appropriate point.

Senator Dixon, will you be staying at this point?

Senator DIXON. Mr. Chairman, I have to go to another meeting, but I have a written statement for the record. I yield to the Chair.

The CHAIRMAN. Very well. It is duly noted, and is made a part of the record.

STATEMENT OF SENATOR ALAN J. DIXON

Senator DIXON. I am pleased to be here this morning as the Senate Banking Committee conducts a hearing on the nomination of Richard Breeden to be Chairman of the Securities and Exchange Commission. I am eager to hear Mr. Breeden's thoughts about where he seeks to lead the SEC.

I expect to support Mr. Breeden's nomination. He is the President's choice. He is a highly competent and intelligent man. He

has a fine legal background, athough it may be somewhat short on the specifics of securities regulation. He has made an intensive study of the regulation of financial services. I may not agee with all or even many of the conclusions of that task force, but I appreciate the fact that Mr. Breeden has carefully pondered these issues.

I want to register one cautionary note. The SEC is a powerful regulatory agency which is supposed to be independent and nonpartisan. Mr. Breeden, I trust that you will remember those words "independent" and "nonpartisan." When you were appointed by Mr. Bush to his Vice Presidential, his campaign, and his Presidential staffs, you were hired to be partisan and not to be independent. Your new job is very different. The SEC must remain independent and nonpartisan.

The SEC, along with our other financial regulators, are facing important challenges. Our financial markets are dramatically restructuring. And the international dimension to capital markets is radically changing as well. Our banks have lost ground to international competition and our securities markets are also threatened. Regulators, together with Congress, must reexamine our laws: Glass-Steagall and various aspects of securities laws in particular. Regulation must respond to real risks, not merely to historical concerns. Regulation must protect the public, not just let industry find the riskiest, lowest common denominator.

I look forward to working with the new SEC Chairman of these and other matters.

The CHAIRMAN. I think I will call first on my colleagues who have come to be here with Mr. Breeden, and we will move along in that order. So at this point, Senator Rudman, we are delighted to have you before the Banking Committee.

We do not see you often, but you are highly regarded here, so we will hang on every word.

STATEMENT OF WARREN RUDMAN, U.S. SENATOR FROM THE STATE OF NEW HAMPSHIRE

Senator RUDMAN. Mr. Chairman, thank you very much for those cordial words of welcome, and Senator Dixon.

I am delighted to appear here. In the interest of time, I will be brief.

I am here this morning with Richard Breeden because Richard is married to the daughter of one of New Hampshire's most prominent families, and a family that I have considered dear friends for a good part of my life.

I have known Richard and known of his achievements. I want to be here this morning to just add my words of support for this nominee. You all have his resume. It is a distinguished resume for a relatively—I will strike "relatively"—for a young man.

He is a graduate of Stanford, Harvard Law School, has served in a number of positions in Government with great distinction. If you look at his resume in detail, the law firms that he practiced law with both in New York and here are among the nation's finest. So he certainly has the background, the intellect, and the experience to discharge this extraordinarily important responsibility at a time when the Securities and Exchange Commission is faced with a mul-

titude of heavy challenges which are more familiar to this committee, certainly, than they are to me.

I just want to say one thing about Richard Breeden, which to me is his most important qualification for this position. There are many positions held by members of the Senate on the issues that Richard Breeden will face and that the Commission as a whole will face. There are, I am sure, disagreements amongst many as to how those issues can be handled. No one would expect this nominee to necessarily agree or disagree with each and every position held by members of the committee or the Senate. That would be most unusual, and would not be expected.

What we ought to expect from a nominee, it seems to me, in this position are several things: First, the intellectual capacity to deal with the issues, which are complex. Second, the personal integrity to deal with the complex matters before this Commission in a totally even- handed and fair manner. Finally, a willingness to listen to the views of others, particularly the views of people who hold key positions in the Congress, who deal with these matters on behalf of a national constituency, which is what this committee does.

On each of those counts, I think you will find Richard Breeden the kind of a man that you want in this position. He has the intellectual capacity, the integrity, the attitude of fairness, and the ability to listen that are so important. In his most recent position, serving the President of the United States as an assistant for issues analysis, and with the work that he did on the savings and loan bail-out which you are all familiar with, I think that he comes well qualified and well prepared for the position for which President Bush has nominated him.

So I hope you will examine him closely, that you will have a good exchange of views; but underlying all of those views, in my view, are the three most important factors for a candidate in this position: integrity, capacity, and fairness. I think you will find at the end of these hearings, as I know Richard Breeden, that you will come to that conclusion as well.

I thank you for the privilege and the opportunity of appearing before the committee.

The CHAIRMAN. Thank you very much, Senator Rudman. That is a very strong, relevant and important statement, and we appreciate receiving it.

OPENING STATEMENT OF CHAIRMAN RIEGLE

Let me say to you, Mr. Breeden, that I want to congratulate you here in this setting, as I have in other settings, on this nomination. It is a great honor and a great responsibility to be seated where you are and to be there as a reflection of the trust and faith that President Bush shows in you through this nomination.

As Senator Rudman said, we on this committee have had the chance to work intimately with you on the savings and loan issue. I want to say, for my part in that effort, that I think we have had an excellent working relationship. It is highly valued especially, because of the work we were able, with the help of many others, to get through, with a very difficult and tight time situation working against us. I have always found our work efforts back and forth to

be open, direct, constructive and positive. I appreciate very much the work we have done, and the work that we will do in the future.

I think it is very important as well for the discharge of this office that you have the confidence of the President of the United States on the way in, and the confidence of the Congress and the people, in the assignment itself.

I think for many years the SEC has had its up's and down's in terms of public visibility, and often was out of the main line of view in terms of things that get front page attention in our nation. I think we are at a time now, however, where events transpiring in the capital markets that directly involve the SEC have made their way off the financial pages and onto the front pages; whether it is the insider trading scandals of unprecedented size, the market crash of 2 years ago, globalization of securities markets, or any other of a host of issues.

Suddenly, the enormous importance of our capital structure, how it works, the fact that it needs to work properly and fully for our economic system to continue to grow, is now presented with great challenges, tests, and difficulties. As I say, I think the fact that these issues have made their way to the front of the national news says a lot about the times in which we live. Clearly, this is an enormous responsibility.

This committee confirms many important Presidential appointments inluding the Chairman of the Federal Reserve Board, the Chairman of the Council of Economic Advisors, and the Secretary of Housing and Urban Development—to name a few—but I consider this confirmation hearing this morning to be as important as any we have held this year.

The rapid institutionalization, automation, and globalization of the capital markets present a host of challenges to the next Chairman of the SEC. How he handles those challenges will directly effect our international competitiveness and financial stability.

I have a number of thoughts regarding the type of person I believe should be the next Chairman of the Commission and I would like to share them with the nominee at the outset before we begin our question and answer period.

First. We need better coordination of regulatory policy over all financial instruments including traditional securities instruments and derivative products. If we are to remain competitive globally we have to re-examine our domestic regulatory structure, to provide, at a minimum, better coordination among our own regulators. And internationally we must take a much more active role in defining the future international regulatory structure. Just as we now have a domestic Securities and Exchange Commission, inevitably events—such as Europe 1992—will lead us toward some sort of International Commission over financial instruments. Without both better international and domestic coordination the threat of systemic financial instability will increase rather than decrease. Any future Chairman of the Commission must be fully aware of this need.

Second. In the thrift bill we just passed, and the President signed into law, the pay caps for employees at the bank regulatory agencies were lifted. The same should be done at the SEC. Securities Subcommittee Chairman Dodd and Ranking Republican Heinz

have taken a lead in this area and I fully support them. If the pay caps at the Commission are not removed the professional staff at the SEC will be encouraged to leave for higher pay at the other financial services regulatory agencies. I would expect the next Chairman of the SEC to be highly sympathetic to this proposal and we will need his support. Likewise, if the pay cap is to be removed, the funding for the Commission must be increased. Two years ago, as Chairman of the Securities Subcommittee, we held a series of hearings at which both industry leaders and corporate securities lawyers testified as to the urgent need for additional funding for the Commission. Then First Boston Corporation Chairman Alan V. Shoemaker testified that "It quite frankly would not disturb me if the SEC's budget were doubled." At a separate hearing, former U.S. Attorney Rudolph Guilani testified that the single cost important action that could be taken to stem illegal insider trading activities would be to bolster the resources of the Commission. That same need is still there and applies to virtually every division of the Commission. The next Chairman of the Commission must be a strong advocate of the funding needs of the Commission because without the leadership and support of both the agency's Chairman together with the Administration, Congress will not be able to act in this area.

Third. It is clear that our securities laws as currently constituted to not deter serious and flagrant abuses. The next Chairman of the SEC must be the strongest Chairman to date in the enforcement of the securities laws. From Wall Street to La Salle Street we have witnessed the most serious violations of both the securities and commodities laws in the history of either the SEC or the CFTC. This has had an adverse impact on the individual investor's perception of the integrity of the markets—witness their lack of participation on the latest bull market.

Last year when we held hearings on market reform I asked three leading financial experts—Don Regan, George Ball and Charles Schwab—whether they thought the market system, the way it had been working, was really fair to the small investor. If you have not read that testimony—I recommend it to you. The response from all three was essentially "no" and Don Regan went so far as to say that "the present game is rigged and we should start by banning index arbitrage and then proceed with other reforms." Other data indicates a sharp reduction in the confidence levels of the individual investor. One clear way to improve it is through an even stronger enforcement division and additional penalties to deter securities laws violations. Repeat offenders—people who violate the securities laws more than once, and often many times—are found too often in the securities industry. New steps are needed to hit hard at repeat offenders.

Mr. Breeden, we will inevitably have a host of other issues we will want to hear from you on—including your views on what, if any, abuses you see in the leveraged buy-out and tender offer process. But at the outset I wanted you to be aware of how seriously this Committee takes this particular confirmation and the issues involved and to let you know that the Committee and I as Chairman have a deep personal interest in the efficient administration of the Commission.

I am prepared to yield to the Republican side here, but I see Senator Warner has joined you at the table. And if Senator D'Amato is agreeable, I think we will invite our colleague, Senator Warner, to make whatever comments he wishes to make here. We are delighted to have you, Senator.

STATEMENT OF SENATOR JOHN W. WARNER, U.S. SENATOR FROM THE STATE OF VIRGINIA

Senator WARNER. Mr. Chairman, thank you very much. I wish to thank you and other members of this committee for moving expeditiously on this hearing. I am very pleased to be here today to introduce to your committee President Bush's nominee to the Securities and Exchange Commission, Mr. Breeden. I have known him for some time personally and professionally.

First, let me welcome to the Senate Mr. Breeden's wife, Holly, and his three sons, Whitney, Prescott, and Todd, who live in the great State of Virginia.

Senator GRAMM. Why don't we have them stand up, Mr. Chairman?

The CHAIRMAN. That would be a good idea.

Mr. BREEDEN. They are already standing. [Laughter.]

Senator WARNER. Mr. Breeden currently serves as Assistant to the President for Issues Analysis. In this capacity, he has been responsible for in-depth analysis on major issues of policy and problems. He also helps to coordinate implementation of presidential decisions in specific issue areas.

As a member of the White House senior staff, Mr. Breeden regularly works with executive departments, agencies, members of the Congress, and private sector organizations. Mr. Breeden is one of the authors of the recently enacted legislation to rescue the nation's savings and loan industry. Working closely with the Treasury Department and the Office of Management and Budget, Mr. Breeden was actively involved in the drafting of this legislation, discussions with members of Congress and financial institutional organizations, in preparation for the implementation of its provisions. He also serves as one of the President's senior advisors concerning the historic overhaul of the Federal regulatory system.

From 1982 to 1985, Mr. Breeden served as Deputy Counsel to then-Vice President Bush. In this position, he worked on regulatory problems in a variety of areas. In addition, he served as staff director of the President's Task Group on Regulation of Financial Services, a cabinet-level group established to recommend improvements in Federal financial regulatory programs. The "Blueprint For Reform," the task group's final report, authored by Mr. Breeden, was issued in November 1984.

From 1981 to 1982, Mr. Breeden served as Executive Assistant to the Under Secretary of Labor. Mr. Breeden was a partner in the law firm of Baker and Botts in Washington, DC, from 1985 to 1989, and he practiced law in New York City from 1976 to 1981 prior to entering Government service.

Mr. Breeden's legal practice has included securities underwriting, mergers, acquisitions, and divestitures, and other types of major domestic and international corporate financial transactions.

His practice has also included bank lending loan work-outs and regulatory matters of various types before the different Federal financial agencies and departments.

Educated at Stanford University with a bachelor of arts with honors in international relations in 1972, and Harvard Law School in 1975, Mr. Breeden is the author of numerous articles for legal and financial publications.

Representing the United States, he has lectured in New Zealand, Indonesia, Hong Kong, and Japan. He has also served as a delegate to international conferences on financial institutions and regulations. In addition to serving on committees for local and national bar associations, Mr. Breeden has served as chairman of the Legal Issues Committee of the Federal Savings and Loan Advisory Council in 1988.

Mr. Chairman and members of the committee, there is no question that the next several years will be challenging ones in the Securities and Exchange Commission. That was indicated clearly by the Chairman in his opening statement. President Bush needs experienced people in key positions, as our nation faces up to the tough choices ahead.

I am confident that Richard Breeden is an outstanding example of just such a person, and I am confident that the committee will do all it can to consider carefully his qualifications and make its recommendation to the Senate in a timely manner.

I thank the Chair and members of the committee. I wish you luck.

The CHAIRMAN. Thank you very much, Senator Warner.

I want to say again to the committee members, we have a vote coming at 10:30. I would like to move on to other opening statements.

I note that Senator Dodd, as Chairman of the Securities Subcommittee, has a comment to make. Senator Robb is just pulling into the station here, too. Mr. Breeden, this is an impressive array of important artillery that you are bringing to the committee with you.

Let me just say, Senator Robb, that we have had very gracious introductory comments by Senator Rudman and now Senator Warner. We would be pleased to have a comment or two from you as well. Thank you.

STATEMENT OF SENATOR CHARLES S. ROBB, U.S. SENATOR FROM THE STATE OF VIRGINIA

Thank you, Mr. Chairman.

I apologize. I told Mr. Breeden I would do my very best to come over and join him this morning if I could slip away. Without having heard either Senator Rudman or Senator Warner, I think I can join in their remarks on this particular case.

I can say that we are always pleased to have a distinguished Virginian nominated by the President to serve in this Government. He has a long background, certainly, in public service. I would say that the fact that he did not have the benefit of a Virginia education—but his credentials at Stanford and Harvard are normally considered acceptable substitutes. [Laughter.]

Mr. Chairman, knowing of the pressures of time on your committee, I will say nothing more than that I am pleased to be able to join in welcoming Mr. Breeden to this committee, and I hope it will be your pleasure to confirm him.

The CHAIRMAN. Thank you very much. We appreciate your comments and your supportive remarks.

Let me just indicate that Senator Garn is not present because he is at the moment on the Senate floor managing the energy and water bill conference report, and must remain there. He regrets not being here at present, but will be here later in the morning as his floor schedule permits.

Senator D'Amato.

Senator D'AMATO. Mr. Chairman, in the interest of time, I would like to ask that the full text of my statement be included in the record as if read in its entirety.

STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Mr. Chairman, I am pleased to welcome Mr. Breeden to the Banking Committee. I would like to observe that as the nominee for this highly sensitive position, Mr. Breeden receives a great compliment from the President. I am certain that the events of October, 1987, serve as a stark reminder to Mr. Breeden of the enormous responsibility which he has been asked to undertake.

In addition to market regulation, the SEC Chairman is the President's man on the front lines of the battle to preserve the integrity of our securities markets and the confidence of investors throughout the world.

On the policy front, we in the Congress will be anxious to hear Mr. Breeden's views on the future of the financial services industry. In the financial services world the date, "1992" has become as much a symbol as "1984" once was in the world of political science. We all know that a great change has already begun in the great global financial marketplace. We also know that we in the United States are losing marketshare in financial services. In the second quarter of this year, the United States posted its first ever deficit in the trade of services. Of course, this trend has been toward deficit for many quarters. The time for action has come to arrest this trend.

We will look for Mr. Breeden's support of the inevitable—a modernization of the structure and the laws governing the banking, securities and insurance industries. A comprehensive approach to this problem is long overdue and the global competitiveness of America's financial services companies hangs in the balance.

I support Mr. Breeden's nomination to be the Chairman of the Securities Exchange Commission. I look forward to working with him once he is confirmed.

Let me add that Richard Breeden indeed receives a high compliment for being the President's nominee to this most important position. I think that speaks eloquently of the background and the ability.

Mr. Chairman, I support Dick Breeden's nomination to the Securities and Exchange Commission as its chairman. I look forward to

working with him once he is confirmed. It is an important position, and we indeed are fortunate to have somebody who is so well qualified.

The CHAIRMAN. Very good.

Senator Dodd.

OPENING STATEMENT OF SENATOR DODD

Senator DODD. Thank you very much, Mr. Chairman.

I want to welcome you, Mr. Breeden, and congratulate you on your nomination to the chairmanship of the SEC.

I will say at the very outset that I appreciate the opportunity provided to me yesterday to have a good long meeting with you and to discuss many issues that we will talk about here today as well.

I might just point out that I read with some interest some of the newspaper accounts and predictions about various things you might do, which are always interesting to read about people before they have had a chance to articulate themselves. Then I listened to you yesterday. Some of the reporters may be somewhat surprised. I found your answers to be very, very different than some of those newspaper articles would indicate.

I do not have to tell you the importance of a strong and effective SEC to the economic health of this country. You understand that very well. Your appointment comes at a very crucial and critical time. A small agency with the responsibility to oversee our vast capital markets, the SEC will be challenged and tested perhaps more than at any time in its history.

As chairman of the Securities Subcommittee, I hope to work closely with you, if you are confirmed, as I am sure you will be, on some of the important and difficult matters facing the agency. If you are confirmed, your first very basic challenge will be one of resource management.

During the past decade, in virtually every area under the SEC's jurisdiction, there has been an explosion of activity. SEC staff levels, however have remained at 1980 levels. We are trying to help on this one, as you know, and I think will be successful.

I was delighted to hear Chairman Riegle's comments this morning. We have next week a mark-up of the SEC authorization bill. One of the issues before us will be removal of the cap on the pay levels. The SEC now can pay a new lawyer coming in at something around $27,000 a year. Top law firms in New York are offering $80,000. Obviously, the competition is not exactly on a level playing field when it comes to attracting good, talented people. So we hope we can change that, as we have with the agencies responsible for regulating other financial institutions. The authorization bill is a long overdue measure.

As we look to the markets under the jurisdiction of the SEC, we see dramatic changes and trends that are inevitable and unstoppable. The job of the new chairman will not be easy. The SEC must reconcile its investor protection mission with the enormous pressures for global competition. Again, I was delighted to hear you say yesterday that that would be an important priority, the whole issue of globalization and how we remain competitive in that field while

simultaneously maintaining regulatory schemes that are fair and equitable.

The institutionalization of the markets has overtaken our old notions of individual investors and long-term shareholders. Small investors are threatened with penny stock fraud and unregulated financial planners, on the one front, and program trading on the other. Many understandably question whether our markets have a place for them. New and innovative products and trading strategies have sorely tested the traditional bounds of regulation, and the jurisdictional issues will be perhaps the most difficult political effort of the new chairman.

The contentious debate over corporate takeovers and the proper State and Federal rules were the subject of years of debate in the Congress as well as the SEC. These issues remain unsettled.

The Commission in these difficult times requires an individual with wisdom and expertise, strength and good judgment. Mr. Breeden, perhaps I should not draw conclusions from our conversations yesterday, but I feel you bring those qualifications to this job.

Let me say one final word about your predecessor, David Ruder. He was and remains highly regarded and respected in the halls of Congress. He spoke his mind over and over again. He took risks, by taking positions that were not always politically saleable; but nonetheless ones that he felt were right. He was not afraid to come forward. He urged Congress to act by sending legislative proposals on a number of fronts.

I told him that I would rather see an agency that was active in proposing new ideas and tackling new problems, even if I disagreed with them, as I did on many occasions, than one wedded to old ways or retrenchment, which obviously is not going to work in the environment in which we now find ourselves.

So we appreciate very much his good work, and look forward to a continuation of that relationship, which I found personally extremely worthwhile.

Again, I feel confident, based on our conversation yesterday, that that door remains open, those phone lines are open, and that kind of contact and relationship will continue and improve the good working relationship between the Congress and the SEC.

I congratulate you on your nomination, I look forward to working with you, and I intend to support you.

The CHAIRMAN. Continuing in the order in which members arrived, Senator Bond.

OPENING STATEMENT OF SENATOR BOND

Senator BOND. Thank you very much, Mr. Chairman.

I, too, have had the pleasure of having an extended discussion with Mr. Breeden. I know that many of the issues that have already been raised will be discussed. I think we have quite a few issues which this committee is going to have to be actively involved in with you. The question of maintaining confidence in the securities market is an extremely important one, as the Chairman said. It has moved from the business pages to the front pages.

In the questions, I am going to ask some of your views on the implications of the global securities markets and the role that the

SEC should play in those, and whether there are additional measures we need to take to ensure the proper protection of investors and the appropriate regulation of securities.

I also want to pursue with you some of the problems in the penny stock fraud area. But with that, I will confine and end my remarks, and just wish you well, and look forward to hearing your answers. Thank you.

The CHAIRMAN. Thank you, Senator Bond.

Senator Shelby.

Senator SHELBY. Mr. Chairman, I ask unanimous consent that the full text of my opening statement be placed in the record.

The CHAIRMAN. Without objection, so ordered.

STATEMENT BY SENATOR RICHARD SHELBY

Senator SHELBY. Mr. Chairman, may I commend you for scheduling this morning's hearing on the nomination of Richard Breeden to be Commissioner of the SEC. Chairman Ruder has expressed his interest in leaving by the end of this month and it is appropriate that this committee should act expeditiously.

Mr. Chairman, I will open my comments by saying that I support the nomination of Mr. Breeden. To date, the only concern that I have heard expressed about his nomination is that he is young; I see no reason to hold that against him. His leadership in resolving the savings and loan crisis demonstrates his ability to tackle monumental tasks. I believe that Mr. Breeden's relative youth will enable him to bring an energetic, bold approach to the issues facing the SEC.

And there are several important issues. Perhaps the single most significant concern is the global challenge which all U.S. industries, including the securities industry, now face. Markets are no longer distinct or isolated but rather are linked by technology, trading strategies, and capital flows. U.S. securities markets face considerable pressure from overseas competitors; the market capitalization of the Tokyo Stock Exchange has grown exponentially in recent years, and the consolidation of the European Community in 1992 poses a considerable challenge.

Intermarket coordination, including clearing and settlement systems will be essential to ensuring the integrity of the market place. Implementing these systems represents a strategic and technological challenge to the SEC.

The SEC will also be called upon to enter the debate on Glass-Steagall. Once again, it is the competitive challenge from abroad that demands that U.S. financial institutions be permitted to provide a competitive mix of products and services. The SEC's involvement will be instrumental during the debate on this issue.

Competitive pressure from foreign manufacturers also presents issues of concern for the SEC. Corporate America is struggling with an astounding debt load as a result of debt-financed corporate takeovers. Even now, as the present economic expansion continues, troubling reports have emerged in recent months over companies that are simply unable to shoulder the tremendous debt burdens assumed during hostile takeovers and leveraged buyouts. Constrained by debt, much of corporate America is unable to respond

with flexibility to the challenges in the marketplace. Part of the problem stems from the present Tax Code, which promotes the issuance of debt over equity. However, the deficit-constrained Federal budget makes a Tax Code change unlikely in the near future. I believe that it is the SEC's obligation to work with Congress, the administration, the Federal banking regulators, and particularly the industry to monitor the levels of corporate debt and to actively enforce margin requirements that may assist in limiting the debt assumed by corporations.

Mr. Chairman, I believe that Mr. Breeden is up to the challenges he faces and I am confident that, under his leadership, the SEC will address the issues. I look forward to the question and answer period.

Thank you, Mr. Chairman.

Mr. Chairman, I want to be brief here. I support the nomination of Mr. Breeden. I have worked with him. I have known him briefly. I believe Mr. Breeden's relative youth will enable him to bring to the SEC an energetic, bold approach to the issues.

You are going to need all the energy that youth is going to bring with you. I have seen your work, I have seen what you can do, and I believe that, in view of all of that, you are going to be the man of the hour.

I support your nomination, and look forward to asking you some questions later.

The CHAIRMAN. Thank you Senator Shelby.

Senator Gramm.

OPENING REMARKS OF SENATOR GRAMM

Senator GRAMM. Mr. Chairman, very seldom do we get an opportunity to vote and nominate somebody that we have worked very closely with. Richard Breeden has been the principal player, along with the Chairman of this committee, in writing one of the most difficult and important bills of the decade. I did not always agree with Richard Breeden on everything concerning the savings and loan bill, but I admired his leadership.

Richard Breeden is clearly a very smart guy. And, as I used to tell my students, the Lord was a great discriminator: he did not make very many really smart people. And so, I rejoice in having an opportunity to vote to confirm someone who can bring tremendous knowledge and brain power to this job.

I join the others who have emphasized the importance of this job. We now have a world financial market, whether we like it or not, and this goose that lays all these golden eggs for us is a wild goose and can fly away. I want you to work to try to see that the goose continues to make his nest in our great nation.

If you will always work to try to promote jobs, growth, and opportunity for the American people, you will not have any differences with me. So I am happy to support your nomination.

The CHAIRMAN. Thank you very much, Senator Gramm.

Another person with a long background in the securities area, Senator Wirth.

OPENING STATEMENT OF SENATOR WIRTH

Senator WIRTH. Thank you very much, Mr. Chairman.

Mr. Breeden, welcome. Mr. Breeden and I had a chance to talk at some length yesterday about my concerns. I will be very brief, Mr. Chairman. I unfortunately will not be able to be back later this morning.

In 1980, the last time we had a major transition at the SEC, the new chairman came in advertising that the administration wanted to do more with less. This was clearly part of a deregulatory strategy in the Reagan administration. That approach was fought very hard by the House subcommittee which I had the privilege of chairing at that time, and by many members of this committee, and we did not allow the SEC to deregulate in the fashion it wanted to. We did not allow this very important commission to take the slow slide which has characterized too many of the other regulatory entities in Washington.

I think Mr. Breeden, and I hope Mr. Breeden shares with us this continuing concern for strong enforcement at the SEC. Senator Dodd has spoken very eloquently, as well as has the Chairman, about the need to augment staff there and staff salaries and to make sure that we are recruiting the best people to this very important agency and keeping them there.

Finally, I would note, Mr. Chairman, that I think maybe the most important thing that Mr. Breeden is going to do in his early days at the SEC is to replace Gary Lynch, who has been I think a clear bellwether for all of us about the intent of the SEC. He has been somebody who is very important to the goals that we all share about assuring that the SEC meets its statutory responsibilities and meets the goals that this committee has set forth.

Mr. Breeden, I look forward to working with you. We have known each other in business and non-business activities. You are a very fine appointment. I want to congratulate you, and look forward to working with you.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Wirth.

Knowing the vote will start shortly, I want to continue on through opening statements by members.

Senator Heinz.

Senator HEINZ. Mr. Chairman, in view of the time, I will be brief. I would ask that my entire statement be made a part of the record.

The CHAIRMAN. It shall.

STATEMENT OF SENATOR JOHN HEINZ

Senator HEINZ. Mr. Chairman, I join you in welcoming Richard Breeden to our committee.

The Securities and Exchange Commission is a fairly small agency with an enormous responsibility to safeguard our Nation's capital markets and protect shareholders and investors. As never before, our capital markets are undergoing rapid changes. The capital marketplace has become international. New financial products are blurring old distinctions between securities and futures. Securities have become one segment of a much larger universe of finan-

cial services. Twenty-four hour a day trading is fast becoming a reality.

The next Chairman of the SEC must explore new frontiers and blaze a path to the capital markets of the next century. The President has nominated Richard Breeden to lead the SEC at this critical juncture. The President has chosen a person with a diverse background and broad perspective on financial services. As important, the President has chosen someone whose talents he knows from firsthand experience and who has clearly earned the President's trust. Those are, indeed, impressive credentials. As the ranking member of the Securities Subcommittee, I can appreciate many of the challenging and novel issues that will confront the next Chairman of the SEC.

In the international arena, the SEC will have to grapple with the coordination and integration of diverse systems of regulation. Harmonizing disclosure and accounting standards will be essential as capital flows around the world. The recent tender offer by Sir James Goldsmith for BAT Industries is a reminder that securities transactions conducted abroad can affect shareholders and companies in the United States.

Cooperation and coordination needs to be addressed at home as well as abroad. The market crash less than 2 years ago demonstrated that there is only one market. Our clearance and settlement systems remain a major concern., The proliferation of new hybrid products with attributes of both securities and futures will require new approaches to regulation. Cooperation between the SEC and CFTC is essential. In addition, the SEC will have the opportunity to further our national market system by examining ways to link our options markets.

Perhaps most importantly, the SEC must remain the tough cop on the Wall Street beat. Penny stock fraud, insider trading, and stock manipulation remain serious threats to the integrity of our markets. Greed is still the drug of choice on Wall Street. A strong SEC enforcement program is essential. As the stakes rise, so much the commitment of the SEC.

Mr. Chairman, I look forward to learning how Mr. Breeden plans to address these important issues.

I want to commend the President for having nominated Richard Breeden for this important job. It is imperative that the responsibilities of the SEC in this increasingly international economic and financial environment be filled by somebody whose experience and depth of knowledge goes well beyond the important, but nonetheless narrow, area of securities law.

In Mr. Breeden I think we have somebody who understands not just the ebbs and flows of securities and financial instruments, but who understands the competitive environment which we face as a country, not only as to our financial institutions, but also the interrelationship between finance and commerce generally.

I find Mr. Breeden an eminently well qualified nominee for this increasingly important position. So I am delighted that he is here. I hope all the members of the committee feel as strongly as I do in his favor.

The CHAIRMAN. Thank you very much, Senator Heinz.

Senator Bryan.

OPENING REMARKS OF SENATOR BRYAN

Senator BRYAN. Thank you very much, Mr. Chairman.

Mr. Breeden brings impressive credentials to this committee. I had a chance to visit with him in my office earlier this week for 30 to 45 minutes. I was impressed with his commitment to protecting the integrity of the marketplace, as well as his philosophy for enforcement. I look forward to asking him some more questions when we have a chance to return after our vote.

The CHAIRMAN. Thank you very much, Senator Bryan.

Senator Sasser.

OPENING STATEMENT OF SENATOR SASSER

Senator SASSER. Thank you, Mr. Chairman.

We have a very important nomination before us today, and I think we are fortunate to have a man of Mr. Breeden's capabilities seeking confirmation from the Senate for this very, very important post.

The first task I think that Mr. Breeden must undertake at the SEC is to aggressively pursue the enforcement effort. He has a reputation as an enforcer. Mr. Breeden, I am encouraged to read of your past accomplishments in that area, because I think there are a great number of excesses in the securities market today, and there have been over the last decade. Some are legal, and some have been illegal. Those persons who have violated the securities laws I think must be brought to justice. They must be brought to justice not only because it helps allay the impression that is abroad in many areas of this country, that the markets are the sole province of the privileged few; but also, speaking as chairman of the Budget Committee, to help some of our budget problems around here.

A little settlement with Drexel, which I think amounted to about $600 million, is a substantial amount of money, even for the U.S. Government.

Second, I think the Securities and Exchange Commission has to be ever vigilant and work closely with the exchanges, so that it can successfully anticipate—if that is possible, and I doubt that it is—but certainly, work effectively and deal effectively with cataclysmic events like that of almost 2 years ago.

Looking back on the events that led up to Black Monday, I am struck that some of the same similarities exist today that were obvious 2 years ago.

Third, I am concerned about some matters which I discussed with Mr. Breeden yesterday. Some are outside of the scope of his narrow role as the Chairman of the Securities and Exchange Commission, but I think he can be of some assistance in the years ahead.

I think we have got to do something about the short-term horizon that our corporate managers have. American companies just are not making the investments they need to make in research and development. We are becoming less competitive as a result of that. One of the reasons they are not is, they are always looking over their shoulder, looking over the horizon for the corporate raider,

and borrowing to buy back their stock at an inflated price. That is not good for the company, that is not good for our economy.

We have a situation in the marketplace now in which vast blocks of stock are bought and sold and held just for a matter of moments. Something like 80 percent of the stocks traded last fall—I saw the figures the other day—are held by giant pension funds, and are traded very, very rapidly.

We in the Congress, I think have to look at this problem. I think Mr. Breeden might be able to give us some help along that line.

Last, I think we need to look carefully at the question of the tax treatment of debt and equity. I do not mean necessarily to reduce the tax paid on stocks, but why should the interest on billions of dollars of debt that has occurred in leveraged buyouts and takeovers be fully deductible? Dr. Greenspan thinks this debt may greatly worsen the next recession, if one ever comes, and he thinks we may be injecting risk into the banking system.

We all learned to our chagrin earlier this year who stands behind all of these deposit insurance funds. I wonder sometimes, why should the interest for these leveraged buyouts be fully deductible, when with a young person's student loan not one red cent of interest on that can be deducted?

Some of these are outside of the scope of your role as chairman of the SEC, Mr. Breeden; but I look forward to working with you in the years ahead. I think you will bring to this post extraordinary intellectual gifts. You are a man of very high energy levels, I am told. So I look forward to working with you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Sasser.

Senator Sanford.

OPENING STATEMENT OF SENATOR SANFORD

Senator SANFORD. Thank you very much, Mr. Chairman.

I am glad to be part of this debate, to welcome Mr. Breeden here and to have the opportunity to talk with him.

I would like to pick up on what Senator Sasser had to say. It is true that enforcement is very important. It is true that it was a landmark accomplishment to get a $600 million fine from Drexel Burnham. But I did a quick calculation and concluded that the taxpayers had already put, by way of interest deductions for junk bonds and related deductions about $18 billion into the takeovers and leveraged buyouts financed through such actions. As such, we did not get very much of our money back.

I also think that we have taken too lightly this whole phenomenon of hostile takeovers and leveraged buyouts and have not given it enough thought. I would hope that the SEC under your leadership not only will be concerned about enforcement and effectively carrying that out, which I know you will, but I would hope we could begin to give some creative thought to the future on several points that Senator Sasser made I especially would hope we will reconsider what our public policy is toward highly leveraged hostile takeovers and highly leveraged buyouts.

It seems to me that great damage is being done to the corporate world. It seems to me that these highly leveraged transactions de-

stroys the level of our competitiveness because corporate managers need to be more concerned with debt service than with product production research and various things corporations ought to be doing to remain competitive in today's economy. It goes beyond just the question of who owns the stock and who could make another buck if you break up the corporation.

It seems to me it is a matter of public policy. What is the effect on the community? What is the effect—indeed, what are the rights of the thousands and thousands of employees that have been laid off in order to pay off the debt?

I would hope that over the next few months that the SEC maybe could give us the benefit of thinking, with a creative view to the future, just what should our public policy be and should we be doing things differently than we have been?

The SEC has part of it, not all of it, but I would look to the SEC as being one of the principal leaders in developing such a policy.

Thank you very much. I have a statement I will put in.

PREPARED STATEMENT OF SENATOR SANFORD

Thank you, Mr. Chairman, for calling for this hearing and I join my colleagues in welcoming Richard Breeden this morning.

There is no doubt that you come before us at a critical time for the SEC. We have read of scandal after scandal involving insider trading and abuses of the markets; more recently the abuses and illegal activity in the penny stock market has become front page news; we are almost 2 years away from the largest drop in the history of our market and questions still remain about the degree of coordination between our equity, options and futures markets; we are facing the ever more complex problems of the global integration of our markets, with complex trading patterns and new products coming to market with ever increasing frequency; and most disturbing to me, we have seen a growing wave of hostile and highly leveraged transactions yet no changes have been made to our securities laws or regulations to address the destruction that these transactions are reaping on our corporations, their employees, bondholders, and our communities.

Indeed, a number of witnesses who appeared before this Committee suggested that the wave of hostile takeovers had abated and we need not do anything. I am afraid that nothing could be further from the truth. In 1988, there was an aggregate of $250 billion in mergers in the United States—double the amount in 1984. The trends are equally disturbing with respect to leveraged buyouts. The total dollar value of LBO's in 1981 was $3.1 billion. By 1988, that number had increased to $60 billion and also shows no signs of slowing. This is the year in which the largest leveraged buyout in history, that for RJR-Nabisco, was completed, followed immediately by the Time-Warner deal and now, in an all debt offer, Sir James Goldsmith is making a play for B.A.T. Industries, with its huge American subsidiaries, including Brown & Williamson, Hardees Foods, Marshall Field's, Saks, Iveys and others expected to be sold or cut back to pay off the huge debt incurred to finance this deal.

I believe that we and the SEC must do more to curb these hostile, highly leveraged deals that are being done, not because they make such good business sense, but simply because of the huge fees and profits they generate for those doing the deals, with the employees and communities who are raided being left to pick up the pieces and work harder to pay off the enormous debts. I would hope in our discussion this morning, Mr. Breeden, you can give us your insights as to what concrete steps you think the SEC should take to address this problem.

Finally, I hope that if confirmed, you will work with the Congress to resolve the issue we discussed on Monday, that of resolving which institutions will be permitted to guarantee signatures for stock transfers. I know it is a very small item, but it has been a lingering issue for some time and now that the FSLIC bill is behind it, I hope we can get it resolved.

I look forward to hearing your remarks.

Thank you, Mr. Chairman.

The CHAIRMAN. Very good, Senator Sanford.

Senator Garn has just joined us.

I will just pause for a second before calling on Senator Garn to say, Mr. Breeden, this is your first opportunity to testify before this committee, although you may have been present in the room on other occasions. I am trying to recall from my own memory. As we go through these proceedings this morning, you are in effect beginning the bonding process that we want to continue on into the future.

But each committee in the Senate is quite different in terms of its makeup, its orientation, how it is operated, and so forth. I think on the Banking Committee, as you start to see and hear from some of the members of this committee—and there are a number of other important members who have not yet come today—you will get some sense of the partnership that we really have to establish together, even though you are an independent agency. This is a committee that takes this job and these issues very, very seriously, as I think you are able to gather.

Senator Garn.

Senator GARN. Thank you very much, Mr. Chairman.

Mr. Breeden, I apologize for being late. Just as the hearing started, I was called to the floor as a member of the Appropriations Committee on the Energy and Water Development bill. I was just going to announce that I succeeded in not having a vote on that bill to keep the committee from having to come over just as another vote occurred.

The CHAIRMAN. Half a loaf is better than no loaf.

Senator GARN. I thought I would spare interruption of the committee.

But in the interest of time and the fact that a vote is here, let me ask unanimous consent that my full statement be placed in the record.

OPENING STATEMENT OF SENATOR GARN

This morning, the committee begins consideration of the nomination of Richard C. Breeden to be the Chairman of the Securities and Exchange Commission.

Dick Breeden comes before this committee after spearheading the administration's response to the savings and loan crisis. There is no question that Dick performed admirably in this task, and clearly demonstrated his expertise with respect to financial services issues, and his ability to get things accomplished. The fact that the final legislation is very similar to that initially proposed is a credit to his and the administration's efforts. His leadership role in the S&L crisis also demonstrated his ability to withstand the heat, and as we all know, the SEC chairmanship can often be a hot seat.

Dick Breeden's wide range of experience in the financial services industry, in both the public and private sector, will enable him to take the necessary broad view of the steps we need to take to keep our capital markets competitive in the increasingly global marketplace. I have long argued for modernization of our Nation's banking laws to keep pace with a rapidly changing market environment. The same holds true with respect to our Nation's capital markets. It is vitally important that the commission, and this committee, recognize that securities and capital markets are becoming

increasingly internationalized, and if we don't take action that will allow our financial services firms to remain competitive, business will flow out of the U.S. to Tokyo, London, or Frankfurt. At the same time, we must maintain the integrity of our markets, to ensure that they are a safe haven for our investment dollars. Dick's insistence on tough enforcement provisions in the S&L bill gives me the confidence that he will vigorously enforce the securities laws and enhance investor protection.

I know that Dick Breeden is sensitive to these concerns, and I look forward to working with him in the months to come. As was demonstrated with the savings and loan legislation, it takes the coordinated efforts of the agencies, the administration, and Congress to deal most effectively with the many challenges confronting us.

Let me simply say to you, Mr. Breeden, I think the President has made an excellent choice. Rarely in some of these nominations do I have the opportunity to know the individual as well as I know you, and I am happy to have gotten to know you. I am sorry that it was over the painful, tortuous issue of the S&L bailout bill. Nevertheless, I did have the opportunity to work with you and see you at work on that particular piece of legislation.

So I welcome you before the committee today and look forward to your confirmation. I think you will do an excellent job at the SEC.

The CHAIRMAN. Before we begin, I have a statement from Senator Cranston for the record. With members going back and forth to the floor this morning, and after Senator Cranston's statement we will proceed.

OPENING STATEMENT OF SENATOR CRANSTON

Senator CRANSTON. I would like to welcome Mr. Breeden to the committee and give him the recognition he deserves as the principal architect of the thrift rescue bill that the administration submitted to Congress. Mr. Breeden seems to be well qualified for the position of Chairman of the Securities and Exchange Commission. I note in his resume that he attended Stanford University in Berkeley, California and has written and lectured extensively on financial reform issues in addition to chairing President Bush's task force on reforming financial services.

Mr. Breeden, your nomination comes at a propitious time: (a) When banks are moving more and more into the securities business and commercial businesses are moving into the banking and securities business, making it more urgent that legislation is enacted to untangle the web of supervision that no longer may be relevant to these market activities; (b) the need for vigorous oversight in domestic and foreign capital markets; and (c) the need to insure competitiveness for our financial services industry in the world markets.

I hope that you will provide Congress with the input that it needs to address these formidable issues along with careful legislation where it is needed. I also would encourage you to take a look at the reform bill S. 530 introduced by Senator D'Amato and myself. I would appreciate your input on this measure.

We are fortunate to have a man of your caliber at the SEC as a member of the Securities Subcommittee, I look forward to working with you in the future on this committee.

The CHAIRMAN. Now, with the vote having started, is that I will very shortly administer the oath to you and invite you to make your opening comments and again introduce to us members of your family and others that may be present.

So I will ask you to hold your formal opening statement, I think, until we recess long enough to go and cast this vote and come back because I would like the members to be present. Several want to hear what you have to say and not get caught in the going and coming process. I would rather that you have your chance to deliver that opening set of comments to the largest assemblage we can have here.

With that, let me ask you to stand and raise your right hand.

[Nominee sworn.]

The CHAIRMAN. With that, we are delighted that you are here. We would like to have you introduce to us anyone that is accompanying you.

STATEMENT OF RICHARD C. BREEDEN, OF VIRGINIA, TO BE A MEMBER OF THE SECURITIES AND EXCHANGE COMMISSION FOR THE TERM EXPIRING JUNE 5, 1993, VICE CHARLES C. COX, TERM EXPIRED

Mr. BREEDEN. Thank you very much, Mr. Chairman.

I would like to have a chance to introduce to you my wife Holly.

My three sons, Whitney, Prescott, and Todd, are also here with me this morning, if they can come out from under the chairs.

Also here with me this morning are my mother and father from California, my mother-in-law Virginia Peterson of New Hampshire, my brother Robert, and my secretary Carolyn Vaughan, whom some of you have had a chance to deal with, who helps to keep me on schedule, an always losing proposition.

I would also like to say hello to Malcolm Lovell, former Undersecretary, of Labor whom I have the great privilege of working for in my first Government assignment.

Senator SANFORD. Why don't we have those three boys stand up?

The CHAIRMAN. Let's have a look at those three boys.

Mr. BREEDEN. I gather one of them has departed. I will say, Mr. Chairman, I hope they were paying very careful attention when some of you noted my relative youth. They have a distressing habit of comparing their father in age to a dinosaur. [Laughter.]

I hope they were taking careful note.

The CHAIRMAN. We are delighted to meet your family, and it is important that they be here because you embark on this together. You are a veteran of high level public service. So you certainly know the burdens that it carries, and I want to just say to your family that we appreciate as well the commitment and the effort and sacrifice that they make. Public service is not easy or simple work. It is a great honor, but it is also a very demanding way to live. We appreciate the burdens upon the families, and very especially, having been through the savings and loan situation, I am

sure the household impact at your house was similar to that at our house.

So we thank the families for their very important part of this team effort.

With that, Mr. Breeden, I am going to recess the committee, hopefully for about 15 minutes. We will go over and make this vote. We will be back. Then we will call on you at that time to make your opening comments.

The committee stands in recess.

[Recess.]

The CHAIRMAN. Let me call the committee back to order.

We will have other votes on the Senate floor later this morning before noontime, so we want to proceed. Other members have had to remain on the floor. In order to make full use of the time we have this morning, I will begin and I ask you Mr. Breeden, to make your opening comments to the committee at this time; any statement you wish to make.

Mr. BREEDEN. Thank you, Mr. Chairman. I do have a few brief remarks, although it is reasonably well-known that that is a difficult assignment for me.

Mr. Chairman, members of the committee, it is a very great honor for me to appear before you this morning. I have always regarded the Securities and Exchange Commission as one of the very finest agencies of the U.S. Government. With an extremely able and capable staff, the Commissioners and Chairman, has demonstrated effectiveness and dedication in protecting investors and maintaining the integrity of American securities markets.

If confirmed, I will devote my full efforts to maintaining and improving this record of the Commission.

In recent years, financial products have become steadily more complex, capital flows have become far more international, and markets have become both more interdependent and more competitive, as this committee knows full well.

These developments offer us many benefits as we seek to create a stronger economy with more jobs and greater prosperity. However, these forces also create new and different problems and risks. Adapting successfully to global market forces, while enhancing stability and achieving the traditional goals of our securities laws, will be a significant challenge for the Commission in the next few years.

Over the past 15 years in both the Federal Government and private law practice in financial services, I have worked with a wide range of complex financial problems affecting our capital markets. Regrettably I have seen firsthand the enormous adverse consequences that can result from inadequacy of our regulatory and supervisory system in financial markets. I have worked on large transactions in the competitive marketplace. Finally, I have had the opportunity to work at length with all our Federal financial agencies to try to identify what works well and what does not.

I would like to thank President Bush for the confidence he has shown in me by this nomination and for the opportunity to work with him over the past few years.

I would also like to thank you, Mr. Chairman, and members of this committee for the speed with which you have begun to consid-

er my nomination. It has been an extremely great pleasure to work with the members and with the staff of this committee in the course of our recent legislative endeavor, and I greatly appreciate your very kind and gracious remarks and can assure you that those sentiments are most strongly reciprocated.

It has been a very great pleasure to work with you in the past, and, if confirmed, I look forward to working very closely with this committee in the future. Most importantly, having introduced them to you, I would like to again thank my family and friends for their encouragement and support.

I would be happy to answer your questions.

The CHAIRMAN. Very good. I appreciate the comments that you have just made as well.

There are several things I want to get into today. Let me start on an immediate issue.

Yesterday, as I am sure you know, junk bond prices plunged in reaction to Campeau's problems. That seems to be a major precipitating factor. There are others, and the junk bond market generally has been showing increasing signs of weakness.

We obviously in our savings and loan legislation have taken S&L's out of the junk bond business in the future and required divestment by those that hold junk bonds now. So there are other aspects that are important at the same time.

My question is how liquid is the secondary market for junk bonds? More importantly, what is the responsibility of the Commission to the investing public in this area?

Mr. BREEDEN. Mr. Chairman, this is an important issue. As I am sure you can appreciate, not having been confirmed and not having been at the Commission in any official capacity, I am only aware of the situation from what I have read in the media accounts.

I would react to your questions on the market itself and the nature of that market and the Commission's role by noting that the so-called junk bond market or high yield market does exhibit some of the same characteristics that the market for investment grade securities exhibits. However, it also has some different characteristics.

Certainly, as in the market for investment grade securities, holders of high yield debt securities are exposed to risks due to the movement of interest rates and the impact that movement would have on the value of their bonds. Likewise, as in the traditional market for investment grade securities, junk bond holders are exposed to credit risks, including the risk of default on the part of the issuer and the consequent diminution in value of the security.

Perhaps differently from the traditional debt market, junk bond holders also are exposed to a liquidity risk, because the liquidity of the junk bond market clearly is not identical to that of the larger investment grade bond market.

Consequently, while this is a risk involved in investing in and holding these securities of which investors should be aware, it is one area that is somewhat unique systemically.

The CHAIRMAN. Excuse me. To the extent that there may well be a problem there or the potential for a problem to develop in the liquidity area, is that an area that you think might appropriately

be a matter of concern for the Commission or a role for the Commission there?

Mr. BREEDEN. Mr. Chairman, I want to be very careful. I am not suggesting that there is a problem at this time in that marketplace. I am just noting that the number of market makers and the degree, level, and nature of the liquidity provided in that market is somewhat different from the broader market for all corporate debt securities.

Consequently, the factors that might affect liquidity in that market certainly are worth the careful attention of the Commission, as well as investors. But I am not suggesting, and would have no basis for doing so at this time, that there is any particular problem in the marketplace today.

Certainly, if you compare the situation 3 years ago or 4 years ago with the situation today, progress has been made in strengthening the liquidity system. The market is less dependent on a single firm as the typical underwriter. There are more firms involved in that market, and consequently there are more firms involved in market making activities who are participants in providing liquidity in that market.

Now, the phase-in of the provisions enacted as part of the thrift legislation pursuant to which S&L's in particular ultimately will cease to be active buyers of these securities, will remove some investors from this marketplace. Over the last 3 or 4 years a number of other types of investors, including insurance companies and very traditional financial firms, entered that marketplace but have not done so with insured deposits, which is an important distinction.

So I think the situation in terms of liquidity is stronger today than it probably was 3 or 4 years ago, but certainly we need to—both the Congress and the Commission need to stay on top of that.

The CHAIRMAN. I don't want to just key off the stories of today on Campeau's problems because there have been a host of other situations, stories, and so forth. And also, I think, much more volatility and instability in the market for junk bonds or high yield bonds, as they are called. As I follow the news, I wonder, with respect to understanding that aspect of how that business works—the liquidity structure, who the people are that make the market and the degree to which there is a market, especially if there were a real test of that market, like a major test of the other markets back a couple of years ago—is that question of the strength and sufficiency of that market, the liquidity and the number of people who are interested in making the market, an appropriate area of study and knowledge and attention by the Commission so that we don't find ourselves advertently or inadvertently moving into a real problem situation?

Mr. BREEDEN. Mr. Chairman, I would answer you unequivocally yes. The Commission has as one of its basic missions concerns about the integrity of our securities markets and all markets, segments including this one. I know the Division of Market Regulation, the Division of Corporation Finance, and other parts of the Commission staff have paid careful attention to developments in this market over the past few years. Indeed, there are currently a number of initiatives under consideration at the commission in this

area, reviewing, for example, the adequacy of disclosure about the liquidity for these instruments.

So I do believe it is an appropriate area of inquiry for the Commission, and certainly, if confirmed, I would have every intention of having a very active Market Regulation Division reviewing this segment of the market, as well as others.

The CHAIRMAN. Very good. My time is up at this point.

Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

Mr. Breeden, as I believe you well know, I have spent most of my 15 years on the Senate Banking Committee attempting to improve the competitiveness of our financial institutions, not only domestically but internationally, and tried on many occasions to deregulate—or I prefer to talk about modernization of our financial institutions.

When I used to talk about this more than a decade ago, I would not have anticipated that the marketplace would have changed as rapidly as it has. I wouldn't have believed that we could have gone from seven out of the 10 largest banks in the world being U.S. banks to 10 out of 10 being Japanese banks. I don't suppose I could have anticipated the technological changes that have taken place that make financial transactions in seconds that used to take days or weeks.

But I am more concerned than I have ever been because of this rapid change with our international competitiveness of our financial institutions.

In light of these changes, what is your view of the competitiveness of American financial institutions, not just securities firms but insurance firms, banking across the board? What is your view of that situation, the competitive situation in the international marketplace?

Mr. BREEDEN. Senator, I share your view that this is an enormously important issue and that we cannot disregard the competitiveness of our financial services providers across the board. I believe the situation today is one in which American financial services companies are confronted with steadily and inexorably growing competition from companies in Japan and elsewhere in Asia, and also from the developments in Europe as we approach EC 1992.

The basic statutes under which we operate, and which financial regulators are charged with enforcing have governed the structure of our marketplace domestically for the most part since the 1930's. In many cases the problems with which we deal every day are problems that—as you well know and have often noted—were not anticipated when Congress constructed those statutes.

I think American financial services firms continue to have many important advantages. We have extremely sophisticated firms. We have firms that are innovative and are leaders throughout the world in the development of new products that will constructively address the financial needs of their customers. However, if we have a situation in which each new product has to be litigated to the Supreme Court to find out who may offer it and who can regulate it, that advantage in innovativeness and creativity can be lost. By the time we finish litigating over the product, it may well be trading actively in Tokyo, London, or other places around the world.

So I think we have a strong and competitive financial services sector, but I do not think we can be complacent about it. We have to pay attention to modernizing our statutes.

Senator GARN. What do you think is the appropriate role for the SEC in trying to maintain our competitiveness on a worldwide basis?

Mr. BREEDEN. Obviously, first and foremost, the Commission's job is to enforce the law as it now exists and to carry out the Commission's responsibilities thereunder.

I also believe that it is important for the Commission to bring the benefit of its expertise, that of the Commissioners and the staff, to bear on reviewing these very complex issues of how we can update and modernize our statutes. I think the Commission's perspectives on free markets and open competition with full disclosure will be helpful in the policy making process in Congress as we seek to modernize some of our statutes.

Senator GARN. You mentioned 1992 and the Europeans. Do you feel this will greatly exacerbate the problem we are talking about, what the Europeans intend to do in just 2 years, really 2½?

Mr. BREEDEN. I think the EC 1992 process can be viewed both as a competitive threat to us and, to the degree that American firms are not discriminated against and can operate more freely on a Europe-wide basis, so long as offering a competitive opportunity. We have a number of firms that have a lot of experience in operating on a geographic scope and that might find it possible to expand their European operations.

So I would not see EC 1992 necessarily as a threat. I think we need to work with that process, to be aware of developments, and to make sure that, if there are going to be problems, we are aware of them and take appropriate action.

Senator GARN. The SEC has repeatedly expressed the view that it should have the authority to regulate certain securities activities of financial institutions. The last time the Senate dealt with this was last year with the Proxmire Financial Modernization Act. Functional regulation of securities activities by a single agency was one of the principal recommendations of Senator Proxmire, which I agreed with. It was also one of the principal recommendations of the Bush task force, of which you were the Staff Director.

In addition, in the administration's initial outline of the savings and loan bill there was a provision which would have resulted in transferring jurisdiction of financial institutions' securities activities from the banking regulators to the SEC.

Do you believe the SEC should have the authority to regulate all securities activities and, if so, would one of your goals as Chairman be to see that functional regulation becomes a reality?

Mr. BREEDEN. Yes, sir, on both counts. I think that, when a bank or a savings and loan issues common stock to investors, questions of investor protection, the adequacy of disclosure to investors, the need for consistent application of accounting principles, and all the other purposes for which the securities laws were created, are as applicable to those transactions as when an airline or a steel company or a computer manufacturer or any other type of firm goes to the public marketplace.

I think it would serve the protection of investors and consistency and economy in Government to let the Commission, which regulates the securities offerings of every other type of business in the United States, regulate them for financial institutions as well.

Senator GARN. Just one quick question. We agree on functional regulation, but would you agree that that change ought to be made as part of a comprehensive financial restructuring rather than just a change in functional regulation?

Mr. BREEDEN. Senator, as you know——

Senator GARN. Just say yes. [Laughter.]

Mr. BREEDEN. These are very much interrelated questions, and a comprehensive solution is always the best one.

The CHAIRMAN. Let me indicate at this point that both my colleagues to my left have very severe time constraints and other situations they have to deal with immediately. So I am going to try to adhere to the time limits.

Let me call first on Senator Shelby and then on Senator Dodd.

Senator Shelby.

Senator SHELBY. Thank you. I will try to be brief, Mr. Chairman.

Mr. Breeden, I am concerned, as has been mentioned here and you are very aware of a lot of concern, about hostile takeovers and leveraged buyouts that we have been discussing. Some of them may not comply with the law.

To cite one specific concern of mine, it is my understanding that most Federal courts are presently denying standing to private parties who attempt to raise the issue of whether or not a particular tender offer violates the margin requirements.

I mentioned this to you earlier when we talked.

It is set out by the Federal Reserve Board, the margin requirements of course. This means, as you well know, that initiation of an enforcement action by the SEC, which you will be Chairman of, I hope—you are going to get my vote for it—is the only practical way to obtain such a court determination.

Are you familiar with what the internal standards and criteria are that can be applied by the SEC in deciding whether or not it is appropriate to file such an enforcement action?

To have standing is very important here, as you well know, and I keep emphasizing.

In my area down in the South, we had the West Point Pepperell takeover by Farley, which you are familiar with. This situation was considered by the Federal Reserve, because I talked with Chairman Greenspan, to warrant a private right of action in the Federal court, thus implying that margin requirements were being violated. However, the SEC did not act on this implication, but rather insisted on explicit instructions from the Federal Reserve.

It would seem that this in fact gives the enforcement authority rather than to the SEC—if the SEC is not going to take an active role in determining when enforcement is appropriate.

Are you familiar with that? I know you haven't been over there yet, but I think this is very important because if you don't have standing in enforcing margin requirements, who does enforce it?

Mr. BREEDEN. Senator——

Senator SHELBY. I know that is a complicated area, but you are a smart man.

Mr. BREEDEN. As I understand the law, the Federal Reserve Board obviously has the authority in the securities markets to establish margin levels. The responsibility for enforcing them——

Senator SHELBY. Right, that is explicit.

Mr. BREEDEN. The responsibility for enforcing those margin requirements does lie with the Commission, and while I will be happy to look particularly at a specific case——

Senator SHELBY. You would have to weigh each case. I know that.

Mr. BREEDEN. These enforcement decisions always have to be made case by case on the merits.

Senator SHELBY. But as Chairman of the SEC, which you will be, as Chairman of the SEC, if those margin requirements are violated and it is the SEC that is supposed to enforce it, will you do that?

Mr. BREEDEN. Senator, I intend to see that the Commission enforce each and every requirement of the laws over which it has jurisdiction.

Senator SHELBY. The second question. I will be brief, and we have discussed this briefly, and this is important now, and that is the one share/one vote proposition.

Other members of the committee know that it bothers me. I believe that if you have a share of stock you ought to be able to vote. That is being challenged. The SEC rule is being challenged in court now.

You told me in my office you thought that they had the authority to pass the rule. Some of us weren't sure before. We thought it might take legislation.

If the courts rule against the SEC as far as authority, would you support legislation to give you that authority?

Mr. BREEDEN. I think, as I indicated, that the Commission clearly has and should have authority over the rules of the self-regulatory organizations. We will find out whether the Court thinks the Commission has the requisite authority. I would be extremely concerned by any judicial action to limit or weaken the Commission's role in this area.

Senator SHELBY. Thank you. Mr. Chairman, that is all I have.

The CHAIRMAN. Thank you, Senator Shelby.

Senator Dodd.

Senator DODD. Thank you, Mr. Chairman.

Mr. Breeden, in an editorial on Monday of this week, the Wall Street Journal heralded the changing of prosecutors, referring to Otto Obermayer's nomination to be the successor to Rudy Giuliani in Manhattan, and, as the Journal characterized you, "free market oriented Richard Breeden" as nominee for Chairman of the SEC.

In that very same editorial reference is made to the Drexel case. The Journal criticized that case, and I quote, "elevating harmless technical disclosure problems to crimes."

The Journal quotes favorably, I might add, from an article written by Mr. Obermayer, which says that the "SEC to some degree has abdicated its role, and criminal enforcement has superseded civil enforcement."

I have several questions I would like to ask you in reference to that editorial.

One, without getting into the cases before the courts, I wonder if you would characterize the charges in the Drexel case as being "harmless technical disclosure matters?"

Mr. BREEDEN. No, sir.

Senator DODD. Do you believe that parking is a harmless technical problem or a more serious one in general?

Mr. BREEDEN. No, Senator. It can be a very serious concern. The Williams Act fairly and carefully crafted disclosure standards, and wilful and deliberate violation of those standards would not be a mere technical act.

Senator DODD. The SEC historically has assisted the Justice Department in the development of criminal cases based on securities law violations. I wonder if you might share with us your view on the need to charge individuals criminally for securities law violations. Do you believe that the knowledge that they can be thrown into jail helps to deter individuals who violate the securities laws? Is the criminal law enforcement an important adjunct to the SEC's civil authority?

Mr. BREEDEN. Senator, the question of the respective roles of civil enforcement and criminal enforcement, and what some have referred to as criminalization of the enforcement program, is a complex one. It has many different dimensions.

But to give you a brief answer, the potential of criminal sanctions is, I think, a helpful adjunct to a civil enforcement program. Whether criminal sanctions are applied in a particular case, of course, requires careful prosecutorial discretion as in any criminal enforcement matter.

Senator DODD. I wonder if you might share your thoughts in another area with the committee as well—you were very blunt yesterday in our conversation. We talked about the Enforcement Division, and I raised with you the same question Senator Wirth raised. It is not fair to ask who you intend to select to replace Mr. Lynch. That is a matter you will have to wrestle with once you attain the position of Chairman, but obviously it is of great interest as to who will fill that slot.

Stanley Sporkin, who left in 1981, was often criticized for being overly zealous. His supporters, however, would argue that since the agency was such a tiny one, it needed to have a tough cop on the beat. Many argued that, because of his reputation as a tough cop, he may have actually ended up with fewer cases, because people were aware there was a tough cop on the beat and they guaged their behavior accordingly.

In our private conversations yesterday, you were pretty blunt in terms of how you see that particular role. I wonder if you might share with the committee today your views about the job of enforcement director of the SEC.

Mr. BREEDEN. Senator, as I recall our conversation, I may have mentioned to you that I began my practice of law in New York during the time when Mr. Sporkin was the Enforcement Director at the Commission. I was brought up and trained to believe that one of my duties as a lawyer to my clients was to make sure that neither my firm nor my client ever had to get a call from Mr. Sporkin. That very healthy concern and respect for the enforcement program is, I think, highly beneficial. Free markets do not work if

investors or participants in those markets believe that they are dominated by fraud, corruption, and other than free market forces, and I believe it is a perfectly legitimate role of the Government to keep the markets clean.

Senator DODD. I appreciate that. I am glad to hear you say that as well. I think it is a good balance, obviously.

I think you pointed out as well—and I have to be careful not to put words in your mouth, but one of the attractive qualities of foreign investors coming to our shores is the very fact that, although we may have disadvantages in other areas, the fact that we have a very clean market in which to invest is a significant attraction.

Mr. BREEDEN. Senator, I do agree with that. In the international context in which we now operate, I think we have to be careful that we don't try to adhere unnecessarily to every stalactite and stalagmite in the interpretation of our laws. We have to try to be flexible and accommodating, but at the same time I don't believe in a race to the bottom internationally. We have standards for the stability and integrity of our markets, and I think the fact that we have clean markets can be an attraction to foreign investors.

Senator DODD. I applaud you for that statement, and I again look forward to working with you in the coming years.

We have several bills that they are pretty much technical in nature coming up before the committee next week, ones that Senator Heinz and I have introduced earlier this year. I gather you have taken a look at those. There are three that will be before us as well as the reauthorization, which you have already discussed, and I understand you are in general agreement with those pieces of legislation.

Mr. BREEDEN. Yes, Senator. As we have discussed, although they are somewhat technical in nature, I would not denigrate their importance. In particular, the International Securities Enforcement Cooperation Act that will be before the committee is very important to provide the Commission with the authority to facilitate the conclusion of cooperative agreements with other securities regulators. In addition, to the degree that any action occurs on the issue of pay flexibility and compensation standards as part of the Commission's budget reauthorization, that is probably the most important issue now facing the Commission.

Senator DODD. I don't know, Jake, whether or not there will be any opposition to the proposition on the pay caps, but my hope would be that your view would be reflected in the White House and that that view could be expressed once we hit the floor and debate that question. I don't know if there is a significant opposition to it.

Senator GARN. I am not aware of any. I cosponsored the bill.

Senator DODD. That is it. You don't have to worry about it. Jake is cosponsoring it. [Laughter.]

The CHAIRMAN. Just so the record is clear, I take it that you do propose to support removal of the pay caps?

Mr. BREEDEN. Senator, I think some of the financial agencies had that authority previously. Now, as a result of the recent thrift legislation, each and every one of the financial regulatory agencies in the Government except the Commission and the CFTC has the authority to set higher compensation levels. I think it is absolutely vital that similar flexibility be given to the Commission.

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That is a personal view. I am not here stating the policy on behalf of the President or the administration, but I do believe it is terribly important.

Senator DODD. As you pointed out, it would put you at a tremendous disadvantage in terms of recruitment.

Mr. BREEDEN. We have a problem, Senator, as you have pointed out, in trying to attract and recruit people into the agency in the first place, given some of the salary standards, and we have an especially difficult problem with turnover. The Commission is blessed with a highly capable staff, but that also means it is a highly marketable staff. We have had some years in which we have lost as many as 15 or 20 percent of the attorneys in the Commission in a single year, and that makes it very difficult to maintain the expertise and experience that we need.

So I do think we must be able to match the salary levels offered by other agencies of the U.S. Government that are engaged in the same types of activity.

Senator DODD. Mr. Breeden pointed out to me yesterday there was a piece of the Federal Page in the Washington Post a week or so ago that compared the turnover rate at Federal agencies. I think I am quoting you correctly in saying that the SEC came out with the highest turnover rate.

Mr. BREEDEN. The Commission last year had a higher turnover rate than any of the agencies that were shown in that chart.

Senator GARN. Would the Senator yield for just one comment, to illustrate the point further?

Senator DODD. Sure.

Senator GARN. In spite of a lot of the press about the Federal Home Loan Bank Board, as you know, we took the pay caps off that back in 1985. It dramatically increased their enforcement powers, and there was a great change in the regulation at that time. If you look at where a lot of those new, highly experienced people came from, they came from the FDIC and the other agencies because the Federal Home Loan Bank Board paid more.

So if we don't—after the action taken in the S&L bill, if we don't free up the SEC, they are going to lose a lot of people they have got to other regulators who can pay them.

Senator DODD. That is a very good point.

Again, I congratulate you and look forward to your confirmation.

Thank you.

The CHAIRMAN. Senator Graham, we are into the question period, and it would be appropriate for you now, if you wish, to make any general comment and then proceed to questions.

Senator GRAHAM. Thank you, Mr. Chairman.

I have no opening statement. I have some questions that I would like to submit for the record and subsequent response.

The CHAIRMAN. Let me just use that as an occasion to say that we will be submitting to you, Mr. Breeden, a number of questions as we have in the past. These will, however, cover the waterfront. Some will come from Senator Graham and other members of the committee. We would ask you not only to answer them as directly as you can, but also we are interested in getting them back, as you would be, in a timely way so that we can move ahead.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Mr. Chairman, if I could use this occasion to return to Mr. Breeden's present and past interest and involvement in the savings and loan issue, I am curious as to what he will recommend to his successors in the White House as to their oversight procedures for the savings and loan reform legislation, including what types of data would you be recommending should be collected and evaluated as part of that evaluation?

Mr. BREEDEN. Senator, we certainly attempted to emphasize throughout the process of working on the thrift legislation that the passage of the bill itself would not solve all the problems. We indicated that there still were hundreds of institutions that had to be recapitalized or permanently resolved in one form or another, and that the legislation is designed to provide the necessary tools to begin that job. The job itself will probably last a number of years.

You are correct to suggest that there will be a long-term effort, and the President certainly recognizes and indicated that when he signed the bill and talked about beginning this job that much hard work lies in front of us in finally resolving that problem and putting it behind us.

One of the very important reforms made by the bill, as you know, was a significant change in the structure of the regulatory system. I am referring to the transfer of the former Federal Home Loan Bank Board to become part of the Department of the Treasury. Although the new Office of Thrift Supervision will have a fair amount of autonomy in how it conducts its regulatory activities, it will do so in a manner and structure very similar to that of the Comptroller of the Currency.

This places the new OTS in a direct reporting line to Nicholas Brady, Secretary of the Treasury. Therefore, the developments in that world will certainly now be a direct and integral part of the Treasury Department's review process, and any significant developments certainly can be reported directly from the Treasury to the President.

Senator GRAHAM. The question that I am specifically interested in is what pieces of ongoing information would you recommend based on your experience and heavy involvement in shaping this reform effort? What data or information should be monitored as an ongoing means of assessing the state of the reform effort?

I might say I am asking that question in order to in part help this committee answer the same question. What information should we be asking for as part of our oversight?

It seems to me that a good starting point would be what do people in the administration who have a similar executive responsibility for oversight consider to be the most relevant and reflective pieces of data to keep a thermometer into the health of this institution?

Mr. BREEDEN. Well, Senator, trying to be responsive, I think that there are probably two major areas where attention has to be focused. One is the permanent resolution of the several hundred institutions that are insolvent as of the passage of the bill in most cases hopelessly so. Those institutions will have to be either closed and liquidated, or recapitalized. Most of the recapitalized institutions will have to be sold to an acquiring institution.

There will be several hundred of those transactions, and I think it is important for the administration and the Congress to monitor the structuring of those transactions and the success in concluding those transactions at the lowest possible cost.

The other major issue, once we have taken care of the institutions that were insolvent, is to deal with the phase-in of the new capital requirements and the accounting standards and to deal in particular with the institutions that were in what I would refer to as the "middle zone."

There are a great many thrift institutions that are very strongly capitalized and healthy. There are a number of them that were insolvent, and there are a number of institutions in the middle. Some of them are going to fail and be unable to meet the new standards, and others can hopefully progress and become stronger.

I think the regulators in the administration and the Congress need to monitor the progress of those institutions pretty carefully, comparing interest rates and deposit premiums with those of banks and other institutions. That is one indication of how the market is proceeding and of the health of those institutions.

Senator GRAHAM. Thank you.

The CHAIRMAN. Thank you very much, Senator Graham.

There are several other issues we want to touch on today, and I have two I would like to go to next. One has to do with the burst in leveraged buyout activity that we have seen in recent years and two is the question of how that can be related to the need for tender offer reform. We have been struggling here for some period of time to close the 10-day window and do other things that we think are generally constructive and fair to shareholders. However, we had a top Transportation Department official warn recently that the Government may soon need to reign in leveraged buyouts and foreign investment in the airline industry, specifically.

The exact quote was that the industry on Wall Street should not "discount the possibility that the DOT will take active steps in response to the levels of debt and levels of foreign ownership being discussed."

That is a rather unique sectoral issue. So I don't want to just veer off into the nature of the airline business and the transportation industry generally. I would rather use that as an illustration and come back into the general issue of the level of leveraged buyout activity; there are hostile takeovers and some friendly takeovers, but there are also takeovers that are driven from inside for taking companies privately. We have seen a great increase in that activity. That often raises questions of whether the incumbent management has access to information not generally known to shareholders, and if there is additional value to be had, why oughtn't it to accrue to the shareholders rather than to a management team that in a sense takes it private and squeezes the shareholders out and somehow accrues the higher value for themselves?

I would like your thoughts on the leveraged buyout situation generally, and I want to know if you see any problems or abuses. You are a very thoughtful man. You have watched this. You obviously have come in with some opinions and viewpoints. I would like to know where you start from on the issue of the level of leveraged

buyout activity and whether you see problems and possible abuses out there that are of concern to you.

Mr. BREEDEN. Senator, as you and all the members of this committee know, this is an extremely important area and it is one that is also highly complex. There are a number of different facets, and I do not want to give you a "hip shot" on this one.

It is difficult to compress that entire, very complex area into a very brief response. I certainly think that the level of leverage in the economy are something that Government should be aware of, and there are times we need to be concerned about it, and so I think it is certainly something we need to keep an eye on.

There are, as you suggest, some unique issues, both with respect to disclosure and procedure, when you are dealing with corporate insiders who are making an offer to the shareholders to acquire their equity. There are issues of whether you can adequately disclose all the information that management may possess.

The Delaware courts and other courts have noted that the transactions in which management is a principal, or at least is one of the potential principals, present some special and unique issues. The Commission has rules, such as rule 13-3, and other requirements, that deal with going private transactions.

There has also been a considerable amount of work at the Commission reviewing whether we need to broaden those rules. In particular, the Commission's rules are constructed to apply to situations in which the corporation itself is acquiring shares. However, in the typical LBO, a third party acquires shares with a significant management involvement. The Commission's work at the staff level in that area and the rulemaking that they have considered are important developments, and, if confirmed, I certainly intend to spend some time on them.

There are very important disclosure issues and shareholder protection issues when you have a proposed transaction by management, and they certainly have to have the Commission's careful attention.

The CHAIRMAN. With respect specifically to this transportation official's comment concerning the airlines and foreign investment coming in, do you share a specific concern in that area?

Mr. BREEDEN. Well, as you know, Mr. Chairman, the airline situation is somewhat unique. The quotation to which you refer talked about the levels of foreign ownership. Obviously, the questions of U.S. flag carriers and the international negotiations that go on with foreign countries as to the awarding of international routes give the Department of Transportation a great deal of discretion to award international routes and to, I suppose, reassign them. So they have equal rights to consider the issue of foreign ownership of a U.S. flag carrier.

It makes that a fairly unique area, and one where the Commission does not have much responsibility.

Certainly, the DOT and FAA, and some of the constituent agencies in the Transportation Department also have responsibilities to ensure that necessary expenditures for maintenance and safe operations are made and that an airline, whether it is one that is in the process of being acquired or whether it is an existing airline, is

soundly and adequately conducted so that the traveling public can be assured of the necessary safety.

So I think that they have some special concerns in those areas which shouldn't be unique to those airlines undergoing a proposed change of control. As to the safety concern, I would be just as worried as someone who travels on airliners a fair amount.

It would be of little solace to know that we were very sure of the safety of airlines that had been involved in a corporate acquisition, but less so with ones that had not. Obviously, safety is an issue that cuts across the board irrespective of whether you have had a change of control.

The CHAIRMAN. I want to, if I may, with the graciousness of my colleagues, I would like to pursue the issue up a notch to a different policy. We will put it in the context of this discussion and maybe we can do that, with Senator Gramm.

It is very interesting to watch how the market has been working in recent years: with who is in and who is out, who is driving the market, where the transactions are occurring and what types of transactions they are, and how much they seem to be driven by primary investors versus people who are doing program trading off index future type offsets.

One thing that is clear and came out of the testimony that I cited, when we had Charles Schwab and others here some months back, is that the small investor really has largely vanished out of the market as a direct investor. They are there in terms of pension fund holdings that come in through institutional management ways, and so forth, but there has been a real backing away of the small investor from the stock market, particularly after the crash.

We see it not only in the primary markets. We see it in the secondary market as well.

I worry about that not only in terms of the level of confidence that it indicates. Can we continue to maintain the flow of private equity capital from that segment, a broad base of individual investors who feel the confidence, feel that they can come in and be treated fairly, that they are not going to be run over by market forces that really stack against them?

At the same time, as I've watched the burst of leveraged buyout activities and hostile takeovers, some of it clearly illegal, we have had plenty of high-profile cases of people who are raiding the markets and running activities which were literally illegal and very much at the expense of shareholders. The shareholders were the losers in those situations.

We have seen an egregious pattern of illegal conduct of this sort on a very wide scale. I do not ask that you then take that tar brush and tar everything else that goes on, that does not fall into that category and that is fair and proper within the law. The question is more of the structure of how the markets work today. The question is whether or not the sheer change in who is in the market and who is out, and in the market mechanisms and market practices, is having the effect of driving more and more activity into the realm of leveraged buyouts and hostile takeovers. Also, because of these factors, as smaller investors tend to back away from the market that has on the average a tendency to depress values.

So then, when a concerted group of players comes in to run values up on a given stock and you get the interplay of market activities, you can take a relatively depressed market level and you can drive up stock shares in a given situation. This occurs especially if you are going to bring the company up in various ways and introduce high-yield bond financing and other things.

This next is an enormously complex issue, but you are a younger appointee and you come in presumably able to take a fresher look, at a time when the market fundaments have changed I think quite dramatically. I would like your sense as to what we may be facing, in terms of what these new market forces are and how they are working, with respect to this huge burst in leveraged buyout activity.

On the level of just the sheer shift in the dynamics of the capital markets, I would like to know if you have concerns or problems that you see out there that you would intend to take a very close look at or would focus the SEC toward.

Mr. BREEDEN. Mr. Chairman, I think you and the other members of this committee are acutely sensitive to the fact that—and you have given an excellent description here of some of the factors that are involved in the marketplace—our markets have changed enormously over the past few years.

There are significant forces at work here, some of which you have enumerated, and others which I know you would have enumerated had we had a longer discussion of some of those changes. I know you are very concerned about some of the international forces in particular, as am I. Our markets are changing, and I think that requires a willingness on the part of the Commission to look afresh at its statutory mandates, because some of the purposes that the Commission is charged with serving—the protection of investors, the maintenance of the integrity of our markets, and ensuring that investors have full and complete disclosure of material factors that they should be considering—are as important as they ever were. But we are operating in a world of very different dynamics.

The Commission has to be willing to rethink issues, to try to bring a fresh approach and creative solutions. Sometimes that is going to involve the need for new legislation. Other times, we will be able to work within the structure of existing statutes.

As you know, in terms of the crunch on individual investors, you suggested that the individual investor has vanished from the marketplace.

The CHAIRMAN. That overstates it; but certainly participation has dropped substantially.

Mr. BREEDEN. I would not say that he or she has vanished. It certainly would be a terrible development if they did. The form of participation has changed somewhat.

You noted the pension beneficiaries. Pension assets are actually a much higher share today than they were 20 years ago, and they are the basic wealth of the average American family. So some of the individual investor participation in the marketplace comes through pension plans. Other individual participation comes from mutual funds, where the individual investor, instead of buying a single stock, buys a portfolio of stocks. Often this is done within a

family of funds arrangement, where the investor can shift from conservative strategies to more aggressive ones, and even to funds targeted on particular sectors.

I do not know that either of those trends is adverse. But I certainly would want to see the Commission activity address factors that we can control that are making individuals reluctant to participate either directly or through one of these derivative means, in the securities markets.

People should feel the confidence to invest in America, to invest in corporations here at home that provide the jobs and the growth that are so vital to our nation.

I think the Commission should have a role in encouraging investment in savings and capital formation in this country. Part of that process is ensuring that investors have the confidence to know that they can participate in these markets, be treated fairly, and have access to comparable types of information that other players have.

The CHAIRMAN. I have gone over my time. I do not think, Senator Sanford, that you have had a question period yet.

Since Senator Gramm and I both have, we are on the leveraged buyout issue. I know that is of keen interest to you. I posed the question before you came in as to whether or not the surge in leveraged buyout activity, hostile takeovers, inside plays by incumbent management, and so forth, were something that had reached the size and dimension that would be of particular concern to Mr. Breeden, and what he might do about it. If you are interested, this might be the time.

Senator SANFORD. Thank you very much, Mr. Chairman.

Mr. Breeden, I had said in my opening remarks that I hoped that you would find time to consider carefully the proposition of takeovers, especially hostile, highly-leveraged takeovers or buyouts, and give us the benefit of whether or not we ought to be shaping a new policy that takes into consideration the interests of the community, of the economy itself, of the employees—all of the elements of society and business that are affected by this kind of conversion of equity to debt that we have seen run rampant.

I do not really want to press you for answers on the details of the policy; but I would like to press you on whether or not you think the SEC should legitimately be concerned with helping us shape that kind of policy.

Mr. BREEDEN. Senator, not only do I think it is an important role for the Commission, but if you did not encourage it, I would hope to encourage it. As you consider these issues, you have available the benefit of the experience and the expertise and the perspective that the Commissioners and the staff can bring to bear on these issues. I would hope that we could participate actively with you in considering them.

These issues are serious. They go to the competitiveness of our economy, and they go to the pattern and nature of the structure of industry here in this country. And if I am fortunate enough to be confirmed, you will find me perfectly willing to engage in a free and open debate and discussion with you on those issues.

Senator SANFORD. I would certainly look forward to it, and I plan to put in legislation within the next week or so. I will withhold it

until we determine whether or not we can get adequate support. There will be hearings this fall that will fit into that.

But I think it is extremely important. I have been watching this for a long time, both as a corporate director and as an interested observer in the economy, and now specifically as a Senator from a State that has seen a number of bad examples—two extremely bad examples. One was Burlington Mills, which was clearly the American leader of the industry. They got a terrific setback by a raid that was responded to through a highly leveraged buyout.

The first thing they had to do was to close their research facility. They have been struggling to be productive, but now must give total predominance to paying off the debt and keeping up with the debt service.

Then we saw R.J. Reynolds, a magnificent company within the State, truly decimated, in the exact meaning of that word: employees laid off, the community that has been one of the bright spots for the promotion of all kinds of civic enterprises just went down the drain. In its place, a heavily indebted corporate skeleton has been left that any little slip in the economy could bring down into bankruptcy. That is my judgment. It is way over-leveraged. I figure the debt-to-equity ratio now is about 130-to-minus-30.

It seems to me that it is no longer satisfactory to take a textbook definition of a generation ago, that the stockholders own the corporation, and whatever the stockholders want to do is all right. The stockholders—especially now, because that pattern of stockholders has changed—are simply computerized to seek the top dollar. That cannot be a good social policy, and it cannot be a good economic policy.

So I just hope that we can give some careful attention to not putting anybody at a disadvantage. In fact, we probably are in the long run helping stockholders. But certainly the quick dollar cannot be an adequate answer.

Let me just raise one other question, if I may. I would hope we could look beyond just this aspect of corporate conduct. That has already been mentioned. But the long-term competitiveness of American corporations is suffering in many ways. Professor Drucker observes that the fear of takeovers motivates managers to look at the very, very short term. That of course is not good for our competitive situation in the world.

So I would hope that you would see the SEC as not just a regulatory board in the way that it was doubtless put together at the beginning, but as a group of concerned people with a great segment of this nation's economy in hand, and help us make it more effective and more productive. Help us use the SEC to allow our corporations to be more competitive worldwide.

Mr. BREEDEN. Senator, I am intensely interested in the subject of the competitiveness of the United States, not only in financial services companies, but in our economy across the board.

One of the reasons why I believe these very complex issues are so terribly important is that they do affect the cost of capital, the rate of savings in the country, the level of investment, and through that mechanism affect the competitiveness of every company in America, and the level of jobs and employment and the creation of prosperity here.

I do not think the President is ambivalent about that. He believes in a strong soundly-based economy and a steadily increasing volume of new jobs. So I would hope to see the Commission do anything it can to help this committee and Congress as a whole to address those issues.

Senator SANFORD. Thank you very much.

The CHAIRMAN. Thank you very much.

We have got a vote that has started. I have now on two occasions called on Senator Graham, and I have yet to let him speak. I apologize for that. We had Senator Pressler come in, and Senator Kassebaum come in. And, Mr. Breeden, as we all arrive at different times, you are getting more and more a sense of the pace and the context of who we are.

I should just say something that I probably ought to have said earlier. We have two former governors seated here on the panel now. Of course, former Governor Peterson from New Hampshire is here today. We are d lighted that that is the case, and we are delighted to have you here. There was an acknowledgement in passing by Senator Rudman, but not in any official way. That was unintentional. We are very delighted at your presence. I know you have a stake in this nomination. That is taken account of.

If I may, I know you two may have opening statements that you want to include in the record, and we will make them a part of the record.

With your indulgence, I would like to honor the promise I made to Senator Graham that I would call on him.

Senator GRAHAM. Thank you, Mr. Chairman.

I have two areas I would like to cover as expeditiously as possible. One is the role of the SEC in affecting the time frame within which economic judgments are evaluated in America.

One of the rationales behind the President's interest in the restoration of capital gains is to try to use the tax law to encourage a longer-range view of economic performance and change public policy incentives with some private sector actions.

Do you see any areas within the control of the SEC that might similarly be reviewed in terms of their contribution toward stretching the time frame for economic judgments?

Mr. BREEDEN. Senator, I am not sure whether I can cite any specific areas within the direct rulemaking authority of the Commission that would control those perspectives in anywhere near as powerful a fashion as some of the other proposals you suggested, such as restoring a capital gains differential.

Certainly, another element in this whole takeover and leveraged buyout issue that the Chairman and Senator Sanford were discussing is the incentive created by the tax code for corporations and the benefits corporations receive for issuing debt rather than equity. A relatively strong penalty is attached to equity in the capital structure.

As long as the tax code operates to create incentives and makes it economically rational and desirable for people to consider replacing equity with debt, we are going to have to expect some of those transactions to occur. We should, I think, be looking at broader policies and ways to encourage a long-run focus on savings and investment and the accumulation of capital. This is a very high pri-

ority of the President and Secretary Brady, and will certainly be one of my policy approaches also, albeit one that is certainly beyond the direct rulemaking authority of the Commission.

Senator GRAHAM. Mr. Chairman, I appreciate that answer, and I also appreciate your indication that this will be an issue that you might give some future attention to.

The second area is on some of your previous positions, particularly in advising on the role of the Federal Reserve Board and the Federal Home Loan Bank Board.

The CHAIRMAN. If I can interrupt just for one minute. In order to shorten the proceeding, I want to come back and finish up on some items. I need to leave now. Can you just put the committee in recess? I will be back in 10 minutes.

Senator GRAHAM [presiding]. Your position has been characterized as one of moving those two institutions under closer control by the Executive Branch. You have mentioned the fact that that largely occurred in the savings and loan legislation as it related to the Federal Home Loan Bank Board.

What is your position relative to the Securities and Exchange Commission? Would you advocate a closer level of Executive Branch, Treasury, or other supervision of your activities, the status quo, or greater independence?

Mr. BREEDEN. Senator, I would like to correct slightly the record. It it is true that I supported the proposals, as finally enacted in the current legislation, to move the Federal Home Loan Bank Board, reconstituted as the Office of Thrift Supervision, into a relationship with the Treasury Department. This relationship was designed to parallel that of the OCC with the Treasury Department, which has functioned quite well since 1963. However, I have never recommended that the Federal Reserve be subject to that sort of relationship.

Senator GRAHAM. I will correct the record and expunge that.

Mr. BREEDEN. As to the Securities and Exchange Commission, I have certainly never recommended that its independence be altered or changed in any way. I believe that particularly important given the Commission's law enforcement responsibilities and the frequent occasions on which it sits as a quasi-judicial body. Traditionally, the Commission has been independent of a direct relationship with the Executive Branch. I think that independence is very important, and it is something that I would both respect and zealously maintain.

I would add just one note, however. I hope that does not mean, and in my view it should not mean, that the Commission would be unable to participate in a broader spectrum within the administration and the Government to discuss and debate policy issues. I believe that, when the Treasury Department or OMB or other parts of the Executive Branch address capital formation issues, they should be aware of the views and the positions of the Commission. I think the Commissioners and our staff have some very important perspectives to bring to bear on this.

So I would hope that, without diminishing our independence in areas where that is terribly important, we would also be able to play a role in policy formation.

Senator GRAHAM. I concur in that division of your responsibilities. I would particularly look forward to your continued active involvement in policy evaluation and recommendations where reform is appropriate. Thank you very much.

The meeting is recessed until the completion of the pending vote.

[Whereupon, there ensued a brief recess.]

The CHAIRMAN. The committee will come back to order.

If people can come back and find their seats, I want to say to you, Mr. Breeden, that your three sons win the annual award for good behavior of children of nominees. So they ought to get an ice cream cone or some suitable treat later for such a good performance here.

Mr. BREEDEN. Mr. Chairman, I hope that they will limit their demands to ice cream. [Laughter.]

The CHAIRMAN. They are entitled to the demand. I think it has just gone up, on the face of my remarks.

I want to ask you about the market crash and reform issues. After the 1987 market break, as you well know, the Brady Commission recommended that one agency should coordinate regulatory issues which have an impact across related market segments. I would like to know your own view, your personal view, on separate SEC-CFTC jurisdiction over financial instruments.

Mr. BREEDEN. Mr. Chairman, the question of the jurisdictional overlap and the jurisdictional boundaries between the SEC and the CFTC, like the issue of whether there should be a single agency regulating commercial banking and the boundaries between the banking and thrift regulators, is certainly an important one.

I have spent a fair amount of time in my career looking at some of the jurisdictional boundary line questions and ways in which we could reform the structure of the agencies themselves, and whether that would materially improve the effectiveness of our programs. I think that the job of bringing appropriate and professional regulation to the areas that require that regulation can be done by two different agencies. We have multiple regulators in the banking industry, which is certainly one industry, one market. We have three different Federal agencies there, as you well know. It is important that those agencies work together, that they set some common standards, that they be closely coordinated in their activities, and that if a person that might be committing unsafe and unsound acts in one type of institution tries to change charters or shift into the jurisdiction of a different agency, that those two agencies would work with each other to be able to react to those problems.

I therefore am comfortable with the existence of the Commission and the CFTC as separate agencies. But I think it very important that those two agencies work closely together, and that we attempt to coordinate and harmonize some of our approaches to common problems.

The CHAIRMAN. As you know, there were some specific things suggested by the Brady Commission as to how that might best be done. They first addressed the issue of whether or not there should be a single regulator. But they went on into the issues of clearance procedures and other things, as to how that cooperation might be accomplished, assuming we had different players in the act doing different things.

Are you satisfied that enough has been done? Can we put that issue aside, or is there more that needs to be done in terms of coordination there?

Mr. BREEDEN. I would note that there have been some improvements, and that some useful work has been done. Some of the reactions and some of the specific recommendations of the Brady Commission in terms of developing better mechanisms for circuit breakers, for example, have been put in place by many of the exchanges. While I would not say that nothing has been done, I am not satisfied that we have done everything that we can do to harmonize operations.

There are, even within the confines of a single market, as the Brady Commission suggested, securities and options and futures represented. Even within a single broad market, there can be very different purposes that are served by different types of products and instruments. That is true even within one segment.

In the securities markets, there are different types of products that are constructed to have features to attract and serve different types of needs and customers, and regulation needs to be sensitive to some of those differences. We do not always have to pursue symmetry to its greatest possible extension.

On the other hand, I think we have to recognize that there are some common problems, and that capital levels, leverage, and other types of issues are common to all the different supervisory agencies.

I am particularly troubled by the long-run implications of some of the continued difficulty in identifying the jurisdictional boundaries between the Commission and the CFTC. We have had some recent litigation in this area. The IP's decision in particular raises some troubling implications for the future, and may ultimately require action by the Congress to improve or clarify some of the jurisdictional boundaries.

But hopefully, if we get to the point of concluding that there would be benefits from legislation in this area, the CFTC and the Commission might be able to make some common recommendations to this committee on how to do that.

The CHAIRMAN. Do you have any specific thoughts in mind of further improvements that you would like to see made, or that you intend to give some particular emphasis to?

Mr. BREEDEN. Well, Mr. Chairman, I have not spent too much time looking at all of the details that I would expect to plunge into if I am confirmed. But I think there are a number of areas in which we can and should make some improvements if I can answer your question without sounding presumptuous.

One of the things I would very much like to do is to develop some type of an exchange program in which senior executives of the SEC can go work at the CFTC for a period of time, and vice-versa, so we can get some of their senior personnel and have them actually physically work at the SEC for a period of time.

I would like to ensure that Commission personnel in an area like Market Regulation, who deal with surveillance questions, for example, are aware of all of the techniques that are used in the futures markets.

At the CFTC, they may develop some techniques that the Commission ought to emulate. Similarly, the CFTC may be able to benefit from the Commissions expertise.

So I would like to see a greater degree of exchange of views between both the staffs and the Commissioner, at the two agencies because we deal with similar types of problems.

The CHAIRMAN. Anything else in that vein?

Are you convinced in your own mind that the leverage factors are about the same across the markets, or not?

Mr. BREEDEN. No, I think leverage factors, such as the margin requirements are very different. As I indicated, there are strong cases made by the futures exchanges and the futures market participants that margin serves a different function in a derivative futures product than it may serve in the purchase of a security.

There are others who note some of those differences, but suggest there are also some public purposes for margin regulation in addition to the purely private purposes between two parties to a trade, and that those public purposes might benefit from a closer comparability than the differences in leverage that now exist.

I would not want to take a position here this morning on whether we can do better than what we have now. But, as you know, the margin-setting authority is quite fragmented in the futures area, as opposed to the securities side of the market. So I think there are some areas that we can look into in trying to better harmonize some of our activities.

Another area that I would enumerate is one which I would like to see us give some serious attention to. That is the whole issue of clearance and settlement. I think one of the Commission's major objectives should be to improve some of the clearance and settlement mechanisms, not just between securities markets and futures markets, but also between U.S. markets and overseas markets.

There are some significant economic benefits that we may be able to derive from cross-margining, for example, where someone may have a position in both the securities market and an offsetting position in the futures market. It is important to enhance the ability to reconcile those two positions, and then have a single margin payment.

Again, I think the Commission should look at improving the clearance and settlement mechanisms between the two markets. And there certainly are some other areas to look into.

The CHAIRMAN. Let me ask you this. There has been a pick-up in program trading. Some of the big players have announced that they are coming back into the program trading area with their own account, with major capital resources.

How do you feel about the level of program trading, and how it seems to be impacting the markets at this point? What would be your thought on that?

Mr. BREEDEN. Mr. Chairman, I have seen some of the discussion of the return to program trading by a number of firms that had perhaps temporarily discontinued that activity. I think it is difficult to make a judgment on an anecdotal basis where a firm says it is going to engage in a certain amount of that activity. The more important question is whether we can get some hard data as to the percentage of volume and transactions that might be accounted for

by a particular program trading activity, such as index arbitrage, that many raise some systemic concerns.

I did see—and I would be happy to furnish to the committee—a study that I believe the Commission's Office of Economic Analysis prepared quite recently, that reviewed over a fairly recent period the levels of aggregate program trading, including index arbitrage. At least as of that time, the volumes had been pretty steady.

There might have been a higher number of companies that were actually employing those techniques, but in terms of the percent of daily trading that was represented in the aggregate, it was pretty steady, and was consistent with the trends over the past few years. I would be happy to furnish that information.

This whole area is one which I know the committee is interested in keeping an eye on and that you are considering very carefully the implications of some of these trading strategies and techniques. I think the Commission as well has to keep a careful eye on these developments.

The CHAIRMAN. I take it, from what I can read and gather, that portfolio insurance has sort of dried up since the crash. Is that your impression?

Mr. BREEDEN. It is certainly my impression.

The CHAIRMAN. I would hope that one of the things you would do is to take a very careful look at those new markets—I do not know whether you want to call them products or devices or activities. All that is very interesting.

I think the post-crash period put quite a different light on some of the things that were not seen quite the same way hours, days, or weeks before the crash. I would hope that there would be a way to carefully understand these new instruments or major new elements that come into the play of the market. We need to understand them item by item, and through all the cross-connections within market segments and across all markets.

Now, that is not easy to do. It is sort of like making sense out of the world economy today, in which so many things are going on at once. It is very difficult to put the whole picture together on a real time basis.

That has been a concern of mine with respect to what is going on in this area. On the one hand, I can see the value of a lot of direct market experience; on the other hand, so much is changing so rapidly that a major application of intellectual force and inquiry and very careful analysis may be in fact as valuable, more valuable, than a vast amount of experience that may extend back even to the prior time period.

I might just share with you a personal aside. I recall when we had John Shad here in his final appearance with the SEC. I happened at that time, which was about 5 months before the market crashed, to ask him if there was any chance that we could see the market go into a highly volatile situation where, say, theoretically, the Dow Jones could drop 500 points in a single day. That was my precise question to him.

I will not take the time to read it to you. His answer was, by and large, "No." That really was sort of outside the range of any sort of reasonable expectation of what might happen, even given all of the new activities.

Then, lo and behold, within a few months we saw the 508-point drop in a single day. We have all been trying to make sense out of it since that time.

In any case, I would hope that very careful analysis of the kind that had to be applied after the fact to the savings and loan situation, could be applied here so that we really understand the inner workings and the dynamics of the system. This is so that we don't wake up one day and find out that we have got problems that we don't understand and maybe even are too big to handle.

I have the distinct view from the Tuesday after the Monday market break a couple of years ago that we came very, very close to a market shutdown.

Is that your view as well?

Mr. BREEDEN. Mr. Chairman, I am not sure I am in a good position to give you an answer to that because I was not really in the loop of the conversations as they were occurring on that day. It is difficult for me to have an independent judgment on that.

Certainly, having read the Brady Commission report and some of the Commission's analysis of the market break, I am aware that the system was pushed to its extreme limits.

The CHAIRMAN. Without prolonging that discussion, I happened on that day, on the Tuesday, to be talking about this development with both John Phelan of the New York Exchange and Leo Melamed. I got the clear impression from those conversations that they both felt that we were literally at the point of a kind of cardiac arrest in the markets. We managed for reasons that still aren't quite clear to come out of that in the afternoon.

But I would hope that you would see as a principal responsibility of yours to try to take us out of—to the extent one can through the regulatory enforcement and arrangements process, to take us out of that kind of jeopardy. This obviously cannot be done in one jump or very quickly, but I would hope that the path that you would see the nation taking as we work with changes in systems, laws, regulations and practices, would bring us away from a situation where we are at a great risk for a market shutdown extreme volatility, of major market breaks.

Without putting words in your mouth, have you thought about that? Assuming your confirmation where do you sort of put that in your order of priorities in terms of looking at the strategic direction of the SEC?

Mr. BREEDEN. Mr. Chairman, I have thought about that. I would like to preface my answer by assuring you I am not expressing any lack of sensitivity to the very important traditional missions of the Commission and the ongoing work in the enforcement area and the ongoing work of the Corporation Finance Division, reviewing the filings, reviewing the day in, day out work of the Commission that it has conducted very well over the last many years. Those are things that we have to place a high priority on and continue to do well. I believe that very strongly.

Having said that, one of the things that I would like to see the Commission bring to this committee and, frankly, to the administration as a whole, is a very strong and sustained analytic commitment to understanding the market forces as they are shaping our markets, both domestic and international. The Commission should

be able to identify where the systemic risks lie before they cause damage, rather than afterwards, and design systems that will help control those risks.

That does not mean prohibiting types of trades or practices. It can mean designing mechanisms, such as the circuit breakers and other devices that have been developed since 1987, that can be very important to deal with volatility that may occur periodically in the marketplace.

I have always been a believer that you cannot do regulatory planning from a basis of optimistic projections. You have to try identify the worst that can happen and plan for it. If you are equipped and staffed and have thought through the response to the very worst problem that can occur, you then can hopefully use that capability, so that everything else will be easier to deal with. I certainly want to see the Commission bring some of that approach to understanding the dynamic forces that are affecting our markets and making sure we have thought through their implications. The Commission then must make sure that it has both done what it can to suggest useful improvements, and also brought those implications and ideas before this committee.

The CHAIRMAN. Very good. Just two or three things, and then I want to finish here. You have been here a long time, particularly considering the interruptions for votes.

Some people have suggested that maybe the Government has been over-zealous in its prosecution of insider trading cases. Obviously, they are tough cases and they take a long time, but we have seen some very substantial results as a result of it.

Do you think the Commission has been over-zealous in that area? The flip side of that is, is it your intention to be very direct and tough in that area yourself in of guiding the Commission?

Mr. BREEDEN. I would not characterize the Commission as having been over-zealous. I think the Commission and its staff have reason to be proud of the cases that have been brought and some of the results that have been obtained.

I express that as a general observation, obviously without commenting on particular cases that have to be judged individually on their merits. And I would not want to suggest any prejudgment of any of the matters, some of which may be back before the Commission.

But just as an overview of the Commission's enforcement activities, while no program is perfect and no program that I know of is immune from ways in which perhaps it can be improved, I think the general focus of the Commission in its determination to root out fraud from the securities markets is appropriate.

The CHAIRMAN. And you intend to continue that?

Mr. BREEDEN. Absolutely.

The CHAIRMAN. Would it then be fair for us to assume that you will be a force that really presses hard against any insider trading that is out there that we can identify?

Mr. BREEDEN. I do not want to sound too much like a lawyer here, but obviously any abuse within the confines that we are talking about, abuses in violation of the laws, rules and requirements of the Commission, will be pursued.

Frankly, I do consider myself to be a strong believer in free markets and in the value of competition in producing efficiency. The market is the best allocator of goods and services that has ever been invented, certainly superior to anything the Government could provide. But at the same time I do not think a belief in the power and the efficacy of free markets need connote a tolerance of those who would engage in fraud and criminality and who would compete in those markets on the basis of price fixing or insider trading or other types of abuses. That is an attack on the market itself. One of the most important elements of any free market, certainly the securities market, is the perception and the reality that it is market forces that are driving results, not fraud and collusion.

The CHAIRMAN. I think it is important to know that you come in at a time when we have seen extraordinary cases of abuse. There has been market rigging, major cases, and fines in the aggregate billions of dollars that are being assigned and collected because of market rigging, market abuse, laws being broken, and so forth.

I think we need to know and hear from you in a straightforward way about the philosophy you have just expressed, which many of us share, about the important value of free markets. We know that they need to be honest markets, open markets; they must not be rigged, abused. We must see that anybody who tries to corrupt the markets is going to feel the full force of the response of this government and of the regulatory agencies in government and, very specifically, the SEC.

In that sense, the people must know that you will be a fair but tough cop on the beat with respect to abuse, and that anybody trying to take improper advantage of the market system will have you to deal with in a very direct way, as the SEC Chairman.

Those are my words, but I think it is important that we hear from you how you feel with respect to that point.

Mr. BREEDEN. Mr. Chairman, I would endorse the way you have characterized it. I would hope that no one would be under the misperception that I would for one moment believe that the interests of the American public or the interests of our securities markets for people to believe that if they engage in knowing and willful systemic violations of our rules and laws that they will not find the Securities and Exchange Commission utilizing all the tools at its disposal to enforce those laws.

If I am fortunate enough to be confirmed, under my leadership that will be the case.

The CHAIRMAN. I appreciate that.

Isn't it also fair to say that some of the abuse that we have seen, even in the teeth of the regulatory safeguards, would imply that at a minimum you need the regulatory safeguards? Unfortunately, it seems that these things are going to happen even despite those, but if one would imagine taking away the regulation as such, it would seem to me that that would invite a pattern of abuse almost beyond imagination.

I think it is very important that we all clearly understand the view of how important the regulatory structure is in this area and how strongly and solidly it is going to be maintained, updated, and applied. This is not with the purpose of trying to hurt markets, but

of trying to maintain the integrity, strength, and the public confidence in the market system, which just has to be there.

So in that sense I would hope that you feel that you are going to be a very active regulator, a fair but strong regulator, and that anybody that thinks otherwise will be making the wrong assumption. I hope that is what we are going to see.

Can we expect that?

Mr. BREEDEN. Yes, Mr. Chairman.

I would add a caveat that I believe is implicit in your remarks. One of the things that I think is important in achieving a climate and achieving a result of a clean market, in which the individuals trading and investing do so on the basis of a common set of rules and not on the basis of some of the types of violations we have seen, is that we also have an element of predictability in the law. People must have an understanding that the law will be extremely vigorously enforced, but the vigor of that enforcement will be best served if the participants in the market that we are going after are also people who had some fair appreciation that the conduct they were engaging in was across the line.

We have to be careful, and I know this committee has looked very carefully at this point, Mr. Chairman, under your leadership. You have looked very carefully, for example, at the issue of a definition of insider trading. There are legitimate concerns people can have of not wanting to draw a road map in some areas to define the law's boundaries, and there are times when the specific facts of a given situation have an impact on enforcement decisions and are difficult to codify and lay down in advance.

But it is important that we have an enforcement program that makes clear to participants in the marketplace the kinds of activities that violate the rules against manipulation, the rules against certain trading practices, the rules that we have in the disclosure area, and so on, and that having made that reasonably clear, as clear as we can the kinds of conduct that will not be tolerated. We then have to make sure they really believe it, and that if anybody has any doubt about that, that we would tolerate these types of deliberate and conscious violations of the law, then we are going to have to disabuse them of that notion.

The CHAIRMAN. I think it is important to start that today, which presumably we are doing here. This is because I think the stampede by some out there to amass enormous personal fortunes using whatever devices and techniques they like, without regard to the law, has reached a scale that it has to be hit head on. You are going to be the key player there, and I think obviously an appropriate way to do that is to send a signal from here today that these laws are going to be enforced strongly and clearly and without exception. If anybody thinks they are going to be able to go out and engage in that kind of conduct, they are going to find that, under you leadership of the Commission, the hammer comes down very hard and very fast.

Mr. BREEDEN. Mr. Chairman, I would subscribe to the comments that you have suggested, within the confines obviously of also wanting people to understand that the Commission in considering enforcement matters has a legal responsibility to consider carefully and individually the facts and circumstances of each case. If I could

add to the list of characteristics of thorough and determined and vigilant enforcement of the law I would also seek to have a fair enforcement of the law as well.

The CHAIRMAN. Very good. Just a last thought, and that is I know that there are a lot of senior people at the Commission that it is important that we retain. Unfortunately, for reasons of the pay situation, the pay differentials, and morale generally, those people may be wondering whether they ought to stay or go do something else. I think it is very important that you do whatever confidence building you can, directly with that cadre of key people that have been around and that represent the important institutional know-how. That knowledge must be preserved, not be shattered and lost, especially at this time. I will work with you in whatever ways I can to help see that this is done. I think it is just critical for you to be able to assume these duties, and to move out into all the areas of responsibility where the really solid in-house capability there be retained to the highest degree and be available to you.

I hope you will do what you can in that respect, and you can count on this committee to be as helpful as we can along those lines.

Mr. BREEDEN. Mr. Chairman, I deeply appreciate your consistent willingness, and we have talked about this on several occasions, to help on this terribly important issue.

I do not know of any single issue facing the Commission today that is more important than our ability to retain the single greatest asset that the Securities and Exchange Commission has, and that is the caliber and quality of its staff.

I am deeply troubled by some of the statistics regarding turnover rates. I will do everything in my power in terms of leadership and motivation and working with other parts of the Government to try to bring an appreciation of these issues.

I certainly appreciate your willingness, as well as that of the other members of this committee, to help in this. It is terribly critical.

The CHAIRMAN. It is crucial, and sometimes you have to use incentives when you don't have the ability to pay comparable rates.

I would hope that good people, solid people, through promotions from within could aspire to higher jobs and certainly earn their way up. There should be a ladder that people can climb based on ability and performance. So there then will be that kind of internal motivation that you can develop and add to the esprit within the organization.

That has to happen. This is very important public service work. People can obviously go elsewhere and do other things.

I see that is going to be a key test of your leadership, but I think it is something that you can do and something that I think is very important be done.

Mr. BREEDEN. Mr. Chairman, it is something I am acutely sensitive to, and I am determined to do everything I can in that area. I share completely your views on how important that is.

I might just toss out one other slight dimension of this because it goes back and relates to the enforcement issues that you have suggested. We are not able to compensate a director of enforcement at

nearly the level at which another financial agency might be able to. That is part of the problem, but another part is the active resources that may be available.

I know at the banking agencies, for example, there have been situations—I think of the Fed and the Butcher chain of banks a few years back—in which there was a major financial fraud with a very complex set of facts. Such a situation may require dozens and dozens of personnel years to develop a hard, solid case and to be able to present it to a court and form the basis of a sustainable enforcement action. In the case of the banking agencies, they are able where such an extraordinary case comes along to use not only the internal resources that they have, but to go outside and, if they need to, to bring aboard a 100 lawyers to help prosecute a case. They can go out and hire them.

Obviously, that raises some issues of the proper oversight and efficiency in some of those activities. There are types of investigations where outside personnel can be used and others where they cannot.

But there is a sharp contrast between the ability and flexibility that the FDIC, for example, may have in that area and the Commission is ability to respond to a case such as those we have seen over the last few years, for example the Boesky case. Attempting to staff such an investigation totally from the internal, preexisting resources of the Commission where you may have 200 private lawyers ranged against 15 or 20 commission staff, which is a massive effort for a single case, is a problem within the current resources of the Commission. I am not saying we should staff up to tens of thousands of people full time, but we need some more flexibility to respond and put substantial resources on major cases.

The CHAIRMAN. No question about that. That is why we gave the Justice Department $75 million a year for the next 3 years on the S&L situation, to track down those cases. You let us know what you need. We will help you get it.

I think your comments have been very positive and forthcoming today. I think you can do an exceptional job, but it won't be easy. It is going to be a real effort, I think, just given the nature of the array of problems out there.

I intend to support your nomination. We want to move it out of this committee as quickly as we can so that we can take it to the Senate floor and get you on the job.

We appreciate your testimony today. We want to wish you and your family well, and we appreciate your commitment to public service.

Mr. BREEDEN. Mr. Chairman, thank you very much.

The CHAIRMAN. There will be a number of questions for the public record, and you will be burning a little midnight oil on these, but I ask you to respond to them fully and promptly.

The committee stands in recess.

[Whereupon, at 1:05 p.m., the committee was adjourned.]

[Biographical sketch of nominee and response to written questions follow:]

UNITED STATES SENATE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

Room 5300 Dirksen Bldg Washington, D.C. 20510

Telephone 202/224-7391

STATEMENT
FOR COMPLETION BY
PRESIDENTIAL NOMINEES

Procedures formally adopted by the U.S. Senate Committee on Banking, Housing, and Urban Affairs January 25, 1979, establish a uniform questionnaire for all Presidential nominees whose confirmation hearings come before this Committee.

In addition, the procedures establish that:

(1) A confirmation hearing shall normally be held at least five days after receipt of the completed questionnaire by the Committee unless waived by a majority vote of the Committee.

(2) The Committee shall vote on the confirmation not less than 24 hours after the Committee has received transcripts of the hearing unless waived by unanimous consent.

(3) All nominees routinely shall testify under oath at their confirmation hearings.

This questionnaire shall be made a part of the public record except for financial information, which shall be kept confidential.

Nominees are requested to answer all questions, and to add additional pages where necessary.

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STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name (Last)(First)(Middle): Breeden, Richard Carroll

Position to which nominated: Commissioner, Securities and Exchange Commission

Date of nomination: September 7, 1989

Date of birth (Day)(Month)(Year): 6 December, 1949

Place of birth: Oceanside, New York

Marital status: Married

Full name of spouse: Holly Peterson Breeden

Name and ages of children: Whitney Reed Breeden, 8
Prescott Hollis Breeden, 6
Todd Peterson Breeden, 4

Education:

Institution	Dates Attended	Degrees Received	Dates of Degrees
Harvard Law School	9/72-6/75	J.D.	1975
Stanford University	9/68-6/72	B.A.	1972
Aviation High School	9/64-6/68	H.S. Diploma	1968

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

California State Scholarship 1968-1972

Scholarships: Stanford University 1968-1972
Harvard Law School 1972-1975

3

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office Held	Dates
American Bar Association	None	Various periods including '87 to Present
Association of Bar of the City of New York	None	8/80-Present
California Bar Association	None	12/75-Present
D.C. Bar Association	None	5/87-Present
N.Y. State Bar Assoc.	None	8/80-Present
Air and Space Museum	None	1986 to Present
Harvard Club of New York	None	1978-1980
Harvard Club of Washington	None	1986 to Present
Metropolitan Opera Guild	None	1976-1978
National Maritime Historical Society	None	1977-Present
Nature Conservancy	None	1977-1979
New York City Opera Guild & New York State Theatre	None	1978-1980
Oceanic Society	None	1977-1979
Smithsonian Associates	None	1986-1988
Stanford Club of Washington	None	1986 to Present
U.S. Naval Institute	None	1987 to Present
Wall Street Planning Group	Trustee	1984-1986
Army & Navy Club	None	1/85-Present
City Club of Washington	None	1/87-Present
Larchmont Yacht Club	None	6/79-Present
New York Yacht Club	None	6/80-Present
Riverbend Golf & Country Club	None	6/83-Present

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Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

Position	Employer	Address	Dates
Assistant to the President for Issues Analysis	Executive Office of the President	The White House Wash., DC 20500	2/89-Present
Partner	Baker & Botts	555 13th St NW Wash., DC 20004	10/85-1/89
Deputy Counsel to the Vice President	Executive Office of the President	The White House Wash., DC 20501	9/82-10/85
Executive Assistant to the Undersecretary	US Dept of Labor	200 Const. Ave Wash., DC 20210	10/81-9/82
Associate Attorney	Willkie Farr & Gallagher	1 Citicorp Cntr 153 E. 53rd St NY, NY 10023	7/80-10/81
Associate Attorney	Cravath, Swaine & Moore	1 Chase Manhattan Plaza NY, NY 10005	10/76-7/80
Instructor in Law	University of Miami School of Law	Coral Gables, FL	9/75-6/76
Caretaker of boat	Levin Campbell	Vinalhaven, ME	8/75-9/75
Law Clerk	Latham & Watkins	550 S. Flower St Los Angeles, CA	6/74-9/74
Research Assistant	Center for Policy Alternatives	M.I.T. Cambridge, MA	2/74-4/74
Law Clerk	Nossaman, Waters, Scott, Krueger & Riordan	Union Bank Plaza Los Angeles, CA	6/73-9/73
Research Assistant	Luke B. Hancock Foundation	2000 Sand Hill Rd Menlo Park, CA	4/72-9/72

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Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

Position	Employer	Address	Dates
Assistant to the President for Issues Analysis	Executive Office of the President	The White House Wash., DC 20500	1/89-Present
Chairman, Legal Issues Subcommittee, Federal Savings and Loan Advisory Committee	Federal Home Loan Bank Board (Unpaid Advisory Committee)	1700 G St., N.W. Wash., DC 20552	5/88-1/89
Deputy Counsel to the Vice President	Executive Office of the President	The White House Wash., DC 20501	9/82-10/85
Executive Assistant to the Undersecretary	US Dept of Labor	200 Const. Ave Wash., DC 20210	10/81-9/82

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Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

Title	Publisher	Date
Blueprint for Reform	U.S. Government Printing Office	November, 1984
"Reforming Regulation of Financial Services in the U.S."	20 The International Lawyer 775	Summer, 1986
"Reform of Regulation of U.S. Financial Services," in Legal Aspects of International Banking and Finance: Loans, Reschedulings and Development	American Bar Association Section on International Law and Practice (pps. 151-198)	July, 1985
"American Financial Changes"	(Fourth Annual) Foreign Banking in America, Foreign Bank Focus, pps. 255-271	March 1985
"Regulatory Reform with the Bank System: Opportunities for the Future"	The Examiner (Vol. 8, No. 3, p. 6)	Winter, 1983
"Regulation of Financial Services: Current Proposals for Change"	Underwriters' Report (p. 18)	August 25, 1983
"Federalism and the Development of Outer Continental Shelf Mineral Resources"	28 Stanford Law Review 1107-1159 (1976)	(1976)
"Coastal Controls in California: Wave of the Future?"	11 Harvard Journal on Legislation 463-508 (1974)	(1974)

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

- Senior advisor, Presidential Transition, 1988.
- Senior advisor, George Bush for President campaign, 1987-1988.
- Senior advisor, Fund for America's Future, 1985-1987
- Volunteer, George Bush for President, 1980
- Volunteer, Bobbie Kilberg for State Senate, 1987

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

Recipient	Amount	Dates
George Bush for President	$1,000	April 1, 1987
Fund for America's Future	$1,000	Fall, 1985

Qualifications: State fully your qualifications to serve in the position to which you have been named. (Attach sheet)

(Please see Attachment A.)

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

   I will remain a U.S. Government employee.

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

   None.

3. Has anybody made you a commitment to a job after you leave government?

   No.

4. Do you expect to serve the full term for which you have been appointed?

   Yes.

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

   None.

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

   My self-directed pension plan currently contains investments in mutual funds that are regulated by the Commission. If confirmed I plan to terminate these mutual fund holdings.

3. Describe any business relationship, dealing or financial transaction (other than taxpaying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

   None.

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration & execution of national law or public policy.

   As a partner of Baker & Botts, I worked on efforts to repeal or modify section 67(c) of the Internal Revenue Code, affecting the taxation of certain registered investment companies. These services included analytic work and discussions with Executive branch officials, but did not include any meetings with, or lobbying of, members of Congress or their staffs.

   While a member of the President's staff, I worked actively to develop and draft proposed legislation to resolve the problems of the savings and loan industry. This legislation ultimately passed the Congress and was signed by the President on August 9, 1989.

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

(SEE ATTACHMENT B)

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

None.

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None.

Attachment A

For more than 14 years I have worked in the field of financial services law and regulation, both as an attorney in private practice and at a senior level in the Federal Government. This work has included a diversified range of domestic and international corporate financial transactions, with special emphasis on the Federal Government's supervisory and regulatory programs for every type of financial institution.

In private law practice in both New York City and Washington, D.C., I have worked on various types of securities offerings and related issues. This work included serving as underwriter's counsel in public offerings of common stock, preferred stock, mortgage bonds, debentures, and other types of securities, as well as standby underwriting arrangements, and private placements of various types of debt instruments and limited partnership interests. I have also represented clients in connection with stock and asset acquisitions and dispositions, tender offers and stock repurchase programs. I have also served as counsel in the negotiation and documentation of bank loan transactions, renegotiation of problem loans and bank regulatory matters of various types.

My law practice has included work on transactions involving numerous countries in Europe, Asia and South America. In addition, I have lectured and attended international conferences on financial issues in several countries in Asia, as well as speaking before numerous legal and financial industry groups throughout the United States.

During my government service, I have worked largely on the regulation of all types of financial institutions, including banks, thrift institutions, securities firms, investment companies, and participants in futures markets. In this work I have studied at length and in detail the operation of the financial regulatory programs of the United States, including the activities of the Securities and Exchange Commission. I have also worked with regulatory authorities in various foreign countries to compare financial regulatory programs.

In private practice or government I have worked with the following financial agencies:

Federal Reserve Board
Federal Deposit Insurance Corporation
Comptroller of the Currency
Federal Home Loan Bank Board
(now Office of Thrift Supervision)
National Credit Union Administration

Securities and Exchange Commission
Commodity Futures Trading Commission
United States Treasury Department

As a result, I have an understanding of the different types of systems designed to maintain the safety and soundness of financial institutions and to protect the public. I have also worked extensively with members of Congress and their staff in the development and passage of legislation.

I was educated at Stanford University and the Harvard Law School. I am admitted to practice law in the States of New York and California and the District of Columbia. I am a member of several bar associations and participate in a variety of seminars and committees concerned with financial services.

Attachment B

Resolution of Conflicts of Interest

I resigned as a partner of Baker & Botts prior to entering my current government employment. However, as a Commissioner, for a period of two years from February 2, 1989, when I returned to employment by the federal government, I intend to disqualify and recuse myself from matters before the Commission in the nature of a request on behalf of a specific party for an exemption from a rule or statute of general applicability, or matters involving the institution of enforcement proceedings, under the following circumstances:

(a) where Baker & Botts represents any party, or

(b) where any of the clients of Baker & Botts (set forth on the attached list), each of whom paid Baker & Botts more than $5,000 in fees as a result of services I rendered to them during the calendar years 1987 and 1988, is a party, or

(c) where I gained significant knowledge from a client while I was at Baker & Botts.

In addition, I intend to disqualify and recuse myself, on a case-by-case basis, with respect to any matter, where, in order to avoid the possible appearance of impropriety, it appears desirable to me to disqualify myself, despite the lack of any actual conflict of interest. Notwithstanding the foregoing, however, in general it is not my intention to recuse myself from general policy considerations, rule-making proceedings, or legislation.

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15A

Recusal Statement

Electronic Data Systems, Plano, TX
Entex, Inc., Houston, TX
Federal Home Loan Bank of Dallas, Dallas, TX
Finalco Group, Inc., McLean, VA
First Western Mortgage Corporation of Illinois, Chicago, IL
Georges, Basil, Houston, TX
Gerald D. Hines Interests, Houston, TX
Gibraltar Savings Merchants Banking Group, Dallas, TX
Gorski, Robert J., Chicago, IL
MBank Abilene, Abilene, IL
Merwin Limited Partners, Westport, CT
MTrust Corp, Dallas, TX
NCNB Texas National Bank, Dallas, TX
Pennzoil Co, Houston, TX
Ramsland, Russell, Jr., Midland, TX
Roy M. Huffington, Inc., Houston, TX
Schultes, E. Alexander, Tysons Corner, VA
TSB Scotland plc, Glasgow, Scotland

Response to Questions from Senate Banking Committee

in Connection with

Confirmation Proceedings

for

Richard C. Breeden

as a Commissioner of the

Securities and Exchange Commission

September 29, 1989

I. Questions from Senator Donald W. Riegle, Jr.

1. Philosophy

You have witnessed first-hand the consequences of lax regulation of the thrift industry and the results of excessive risk-taking to the public and the taxpayer. What lessons have you learned from this experience and how, if at all, has the thrift debacle (together with the October 1987 crash break and all the indictments that have been handed down recently in both the securities and commodities markets) affected your views on securities regulation and your overall regulatory philosophy?

Among the lessons that I have learned as a consequence of the disaster in the thrift industry are the following:

- Accounting principles play a vital role in providing information necessary for regulators, policymakers and others to judge the condition of a financial institution. Distorted accounting principles adopted for "regulatory" purposes other than full disclosure can cause deteriorating trends to remain unnoticed.

- Capital plays an essential role in providing discipline for financial institutions and serves to deter against unwarranted risk-taking, especially by institutions with federal deposit insurance. Capital standards set by supervisors are essential to establish a minimum benchmark for prudent operations.

- Disclosure policies for insured institutions and their securities should be established by an agency <u>other than</u> the primary bank or thrift supervisory agency to insure that risks tolerated by supervisory authorities are publicly disclosed.

- Supervisory authorities must be allowed to take appropriate enforcement action free of political pressures -- from Congress or an Administration. Institutions engaged in serious fraud or other wrongdoing must not think that they can obtain political relief from enforcement action.

- Delay in addressing cases of deteriorating financial condition and violation of regulatory standards often results in much larger ultimate losses than would result from swift enforcement action.

The thrift experience has largely confirmed my prior views rather than changing them. I have always believed in strict enforcement of safety and soundness standards. Government regulation of financial institutions should seek to establish and to enforce minimum standards and rules of conduct, including capital, accounting, disclosure and other regulations necessary to prevent fraud, manipulation or similar abusive practices. At the same time, market entry and exit, product offerings, pricing, locations for doing business, affiliations and other aspects of economic competition should be left to market forces as much as possible.

If anything, the thrift crisis has demonstrated the need for elimination of the "regulatory" exceptions to the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"), including the bank and thrift exemptions in Sections 3(a)(2) and 3(a)(5) of the Securities Act and the bank and thrift reporting provisions of Section 12(i) of the Exchange Act.

2. Special Study

> As the markets have become increasingly automated, institutionalized and complex, more and more securities experts are recognizing the need for, and are suggesting, the creation of another independent Special Study along the lines of that conducted by the Commission and Milton Cohen in the early 1960s.
>
> Are you familiar with that Special Study and what is your reaction to taking a fresh look at a number of the new trends that have taken place since then?

In 1961, Congress directed the Commission to study the adequacy of the system of self-regulation in the securities industry and to recommend any necessary legislation. The result was the Special Study of the Securities Markets, prepared at the direction of Milton Cohen and submitted to Congress in 1963. The Special Study's recommendations formed the basis for the Securities Act Amendments of 1964.

In 1988, as part of the Insider Trading and Securities Fraud Enforcement Act of 1988, Congress directed the Commission to conduct a comprehensive study of the securities laws, but made the Commission's obligation contingent upon receiving a $5 million appropriation. Such an appropriation was not included in the Commission's FY 1989 budget, and the Commission did not request this money in its appropriations request for FY 1990.

3

The Commission has not taken any position on the need for a new Special Study.

If confirmed, I intend to lead the Commission in considering the implications of many of the trends that have affected our capital markets in recent years. Numerous studies and other relevant information already exist in the literature regarding financial services that can form the basis for sound policymaking. Another study might delay the process of modernizing our statutory programs without developing significant new information or perspectives. I believe the Commission should, on an ongoing basis, provide Congress with analysis of market trends and reevaluation of existing statutes and regulatory programs. Toward that end it would be more desirable to increase permanently the Commission's analytic capabilities rather than to perform a single study on a temporary basis.

3. Insider Trading

> Support for clarifying the laws on insider trading ranges from industry groups such as the Securities Industry Association to former prosecutors and government officials such as Judge Stanley Sporkin, the former head of the SEC Division of Enforcement, former Treasury Secretary Don Regan, and former U.S. Attorney Rudolph Giuliani. Last Congress Senator D'Amato and I introduced legislation, S. 1380, which in plain English clarifies the law in this area. This bill was drafted with the assistance of an Ad Hoc Committee consisting of some of the top securities lawyers in the country who represented a cross-section of interests.
>
> What is your position on whether the law on insider trading should be clarified by statute?
>
> If confirmed would you support S. 1380, the insider trading bill I introduced together with Senator D'Amato last year? If not, why not? What changes, if any, would you make to it?

S. 1380 was the product of months of intensive effort by the Ad Hoc Committee, the Commission and its staff. Issues that arose in drafting the bill were complex and controversial, as reflected by the fact that the Commission's support for legislation was neither unanimous nor unqualified.

Since introduction of S. 1380, several important developments have occurred. First, the courts have had further opportunity to address insider trading issues and to provide further clarity to the law. Most notable in this regard was the Supreme Court's decision in United States v. Carpenter, which did not disavow the use of the misappropriation theory of insider trading liability by the Second Circuit. Second, like the courts, the Commission has added to the body of insider trading law through its enforcement actions. Finally, Congress has further addressed insider trading through enactment of the Insider Trading and Securities Fraud Enforcement Act of 1988. As a result of these and other factors, it is my current understanding that the lack of a codified definition has not impaired the Commission's enforcement actions to date.

Given the further development of the law of insider trading by the courts, Congress and the Commission since S. 1380's introduction, the circumstances that originally appeared to call for a definition of insider trading may have changed. Indeed, there may be advantages in the enforcement area to be gained from further administrative and judicial development of the concept. If confirmed, I will work carefully with the staff of the Enforcement Division and other Commission staff, as well as the other Commissioners, in reviewing the need for a legislative definition.

In reviewing this issue I would seek an appropriate balance of two somewhat inconsistent objectives. First, clarifying the scope of wrongful behavior -- especially in the criminal area -- would be desirable so that market participants can effectuate transactions expeditiously and with certainty as to their legality. On the other hand, too much rigidity in the elaboration of prohibited conduct could hamper the legitimate exercise of enforcement discretion in responding to new types of fraudulent conduct.

4. Insider Trading

> To what extent do you believe that front-running and trading on advance information between the securities and commodities markets has been a problem?
>
> How about securities firms buying and selling for their own accounts ahead of their individual customers?

In its broadest terms, "front-running" generally is defined as trading on the basis of nonpublic market information regarding impending market transactions. Prior to the advent of derivative securities markets (i.e., stock options), such practices generally were limited to brokers trading in the same security

prior to the execution of a customer order. These practices, known as "trading ahead" or "scalping," always have been viewed by the Commission as serious violations of a broker's fiduciary duty to the customer. They also have been prohibited by federal securities law and exchange rules.

In the securities markets, the term "front-running" has been defined as the specific practice of trading in the derivative securities market and the underlying market for the security to take advantage of material, nonpublic market information regarding an impending transaction.[1] It has become evident over the last few years that opportunities now exist for similar trading practices involving trades with stock index futures contracts and the securities markets (a practice described as "index front-running").

As with other types of front-running, many if not all of the securities regulatory organizations ("SROs") have prohibited their members from engaging in intermarket index futures front-running. Several of the SROs have tried to adopt common definitions of violations. For example, the New York Stock Exchange ("NYSE"), Chicago Mercantile Exchange ("CME") and the New York Futures Exchange ("NYFE") have agreed on common definitions of intermarket index futures front-running violations, as well as formal procedures for sharing surveillance and investigative information to curb commonly defined abuses.

Because of the regulatory division between stock index futures -- regulated by the Commodities Futures Trading Commission ("CFTC") -- and securities, the detection and prosecution of intermarket index futures front-running requires effective sharing of data and information and the coordination of investigative and prosecutorial functions. If confirmed, I will evaluate the adequacy of current cooperative efforts, as well as the prevalence of abuse detected by current surveillance.

5. Leveraged Buyouts

> How do you respond to criticism that management has an inherent conflict of interest in a number of leveraged buyout deals because they have inside information

---

[1]The term "customer front-running" is used to describe a practice where a securities broker trades a derivative security for its own account to take advantage of nonpublic information concerning the execution of a customer's order for the underlying security. In contrast, "self front-running" describes a practice involving trades in a derivative security to take advantage of nonpublic information concerning the execution of an order for the firm's own account rather than for a customer account.

that is not readily available to all shareholders and, in taking a company private, they act upon it?

Do you think long-term bondholders are treated fairly in these deals where often they see the value of their bonds drop dramatically overnight?

Under state law, corporate directors owe duties of care and loyalty to the company and its equity shareholders. Where a transaction involves the potential for self-dealing, courts have required directors to demonstrate good faith and the inherent fairness of the bargain, including, under recent case law, demonstrating that the transaction offers the highest price currently obtainable.

As a practical matter, it is difficult to eliminate entirely management's inherent informational advantage. However, procedures can be designed to isolate interested directors from consideration of a transaction. Disclosure of management's interest in the transaction and a description of the procedures and analyses followed to evaluate a transaction, as specifically required under Commission Rule 13e-3, permits shareholders to evaluate the impact of the conflict on the transaction and to pursue remedies in the state courts. For example, the Commission already requires disclosure regarding many of the following items, and may consider proposing further disclosure concerning:

- potential conflicts of interest when management is involved in a transaction;

- disclosures to shareholders about the intrinsic value of their corporation;

- management efforts to obtain the highest price for shareholders;

- providing shareholders with the same information considered by the board of directors in evaluating a management buyout proposal;

- recapitalizations that affect control of a corporation in favor of management and other insiders; and

- providing shareholders of a target company with non-public information and reports provided by the target to potential acquirors.

To date, it has been fairly clear under the law of most states that a fiduciary relationship does not exist between a

bondholder and the company and its directors. Rather, a bondholder's rights are purely a matter of contract. The contract or indenture underlying the bond establishes the rights and responsibilities of the two contracting parties. Thus, a bondholder is treated "fairly" if he or she receives what was bargained for, including all the protective covenants contained in the bond indenture.

Accordingly, the best method to protect bondholders lies in the rules assuring adequate disclosure. The staff of the Division of Corporation Finance is reviewing and evaluating the status of the current disclosure in the offering materials distributed to prospective bondholders. The staff should consider whether to propose changes in the appropriate rules and schedules to ensure that the risks of going-private or other leveraged transactions are fully disclosed.

In addition, the market may respond to the risk of a significant change in the capital structure of an issuer by requiring more protective covenants for bondholders. Such provisions (usually negotiated by the underwriter) generally allow the bondholder to exercise an option to sell the debt instrument back to the issuer upon the occurrence of a certain specified event, such as a change of control resulting in a downgrading of the issuer's bond rating.

6. International Issues

> There is increasing concern with the internationalization of the capital markets. Do you believe the SEC should be doing more in response to this phenomenon? If so, what specific measures should the Commission initiate or support to facilitate international trading and appropriate regulation of such trading?

Yes. While the Commission has made important progress in a number of areas, I believe it should respond even more actively to the internationalization of our capital markets. Among the most important objectives should be improved clearance and settlement systems, common capital adequacy requirements, harmonization of accounting standards and conscious efforts to avoid any unnecessary impediment to the international competitiveness of U.S. markets or U.S. financial services firms.

Improved systems to disseminate market information, continuing improvements in mutual enforcement assistance and enhanced cooperation in defining and preventing abusive and fraudulent practices are also important. Finally, the Commission's efforts to achieve greater mutual recognition of

securities offerings and other disclosure materials, as well as to simplify procedures for mutual recognition of oversight of market participants such as broker-dealers, should be continued and enhanced.

7. International Issues

> As financial markets become even more global, how can we, as a practical matter, avoid the tendency for all common nations to compete for expanding influence by offering the least regulation regardless of merit?

The Commission has worked to develop common understandings among countries regarding minimum standards for the emerging global securities markets. These efforts have resulted in significant steps toward harmonized standards for investor protection (e.g., the emerging consensus that insider trading is an unacceptable practice in modern securities markets, the development of minimum capital adequacy standards, and work on multi-jurisdictional disclosure documents). Especially with committed American leadership, cooperation among the world's securities regulators can help avoid a "race to the bottom" in regulatory standards. Moreover, the reality, as well as the perception, of fair and orderly markets can contribute to the competitiveness of U.S. markets, so long as regulation does not become excessive or stifle innovation.

8. International Issues

> Should there be uniform international standards for registering and selling securities?

It is highly unlikely that uniform global standards will be developed in the near future due to the traditional differences in national practices. Indeed, a "uniform" rule could be highly adverse if it did not meet the needs of U.S. markets. In some specific areas, it may be possible to develop uniform or closely similar standards. It is more likely, however, that increased regulatory coordination and mutual recognition of home country requirements provide the best opportunities for increasing the efficiency of the global capital markets while assuring investor protection.

This approach was followed by the Commission in its recent decision to propose that specified types of Canadian issuers could use Canadian disclosure documents to satisfy registration and reporting requirements for offerings in the U.S. This system could be utilized as a prototype for additional jurisdictions that have disclosure systems designed to assure that investors are given information adequate to permit them to make an informed

investment decision. By permitting use of Canadian offering materials, U.S. investors may have greater investment opportunities due to the reduced time and cost for a Canadian issuer to extend its offer to the U.S.

Coordination and accommodation of legitimate, ordinary course foreign market practices may also be a more practical and timely means of addressing differences in stabilization and other distribution regulations among jurisdictions than seeking uniform rules.

9. International Issues

> Should the Securities and Exchange Commission accept, for sale in the United States, foreign registered securities that meet the standards for countries with a developed, sophisticated system for registering and selling securities and reporting financial results?

A primary challenge facing the Commission is removing unnecessary impediments to transnational capital formation. Therefore, in appropriate circumstances the U.S. should be prepared to allow the sale of foreign-registered securities, using foreign disclosure documents, where this action would be consistent with maintaining minimum U.S. standards. However, this objective must be accomplished in a manner that does not unduly disadvantage U.S. issuers in the U.S. markets, and that provides investors with the essential protections mandated by the federal securities laws.

10. International Issues

> Should the Securities and Exchange Commission be prepared to accept financial statements prepared on the basis of accounting principles other than generally accepted accounting principles as promulgated by the Financial Accounting Standards Board ("FASB")?

In some circumstances, the Commission currently accepts financial statements of foreign issuers prepared in accordance with home country accounting standards. This practice is an appropriate recognition of the fact that the entire world is not prepared to follow the pronouncements of the FASB. The Commission does require, however, reconciliation of income and equity to U.S. accounting standards. The Commission should be prepared to expand this practice as a means of reducing the cost of capital, while maintaining adequate disclosure standards.

11. International Issues

> At the present time efforts are being made to develop a body of international accounting standards, some of which may not be as stringent as those prevailing in the United States. Would you, in the interests of facilitating international trading of securities, favor adopting the proposed international standards in preference to those prevailing in this country?

Whether I would favor the use of international accounting standards in preference to comparable U.S. standards would depend on the specific standard, and the tradeoffs that would be involved compared with use of the American standard. Accounting standards that are not "as stringent" as those used at any given time in the U.S. may still provide a relevant and reliable presentation of financial condition. Conceivably, in some areas accounting standards developed outside the U.S. may be superior to U.S. standards. Certainly the development of mutually agreeable international accounting principles and auditing guidelines would reduce unnecessary costs resulting from disparities among the various national standards. However, I do not believe that convenience or uniformity are sufficient reasons for the U.S. to accept accounting principles that are inadequate in their presentation of relevant and reliable information.

12. Financial Instability

> The threat of systemic financial instability in the United States, and in the world, appears to have grown considerably in the last decade due to the growing integration of financial markets, faster execution of transactions, decreased transaction costs, and the telecommunications revolution which makes information available instantly throughout the world.
>
> What specific steps do you believe should be taken now to reduce the threat of such systemic instability? How likely do you think it is that such instability -- or another market crash along the lines of the one we experienced in 1987 -- will occur any time in the next 4 years?

The factors suggested, such as improved communications and faster execution of transactions, may also reduce risks, and they do not necessarily harm systemic stability. Excessive levels of risk or speculation, backed by insufficient capital, would be

more likely to lead to problems if such conditions were widespread, or occurred in major firms. Certain risks, such as liquidity risks, may be greater today than was true in previous times, at least for certain firms.

In the past decade, the unprecedented growth and change in financial markets (including, among other things, the increased internationalization of securities markets and the growing tendency of firms to take proprietary risk positions in dealing with their customers) have resulted in the need for broker-dealers to accumulate large capital bases. To obtain the levels of capital necessary to compete on a global basis, some large firms have become public companies through equity offerings, some have increased their leverage, and others have affiliated themselves with other entities. Many firms have created holding company structures to facilitate their world-wide growth.

As the structure of large securities firms has grown more complex, and their scope of operations has widened, registered firms may have moved many potentially risky activities, such as interest rate swaps, bridge loans and foreign currency transactions, out of broker-dealers and into affiliates or holding companies that are not under direct regulatory oversight. In some cases, this results in the avoidance of significant capital requirements that would be applicable if such activities were conducted in the broker-dealer.

One important method of reducing systemic risk would be to give the Commission explicit authority to monitor and to evaluate risk-taking in affiliates of broker-dealers that could adversely affect the liquidity of any such firm. Analyzing and monitoring the risk to large broker-dealers based on a review of consolidated activities would help the Commission predict and control excessive risks to the stability of the overall system. However, since the integrated securities firms now conduct a major part of their business in holding company affiliates outside the registered broker-dealer, any such proposal for consolidated risk analysis would have to be carefully reviewed, and the specific comments of the industry taken into careful consideration to avoid unnecessary costs or unnecessarily expanded regulation.

Another specific step that could materially reduce instability would be to improve the speed of global clearance and settlement procedures. The 1989 Group of Thirty Report on Clearance and Settlement in the World's Securities Markets made useful suggestions on improving international clearance and settlement.

If confirmed, I will pursue an active program to address systemic risk on a domestic and international level. While I do not have any basis for predicting the likelihood of specific

market events, the steps I have suggested would put the Commission in a better position to evaluate the risks and to reduce the likelihood of instability in the world's financial markets.

13. Glass-Steagall

> What is your position on repeal of the Glass-Steagall Act? If the Act is repealed who should regulate the activities of both banks and broker-dealers?

The Commission has supported repeal of the Glass-Steagall Act, so long as repeal is accompanied by the requirement that banks conduct most of their new and existing securities activities in separate securities affiliates or subsidiaries subject to Commission regulation. I support the Commission's general position, but only if the entire regulatory structure that would replace current law was adequate to protect the integrity of securities markets and to provide competitive opportunities that would be both theoretically and practically equal for different types of financial firms. To this end, I believe that the Bank Holding Company Act of 1956 would have to be amended significantly simultaneous with any repeal of Glass-Steagall in order to achieve competitive equity and stability.

In general, I do not favor arbitrary or artificial restrictions on competition per se. I do believe that it is perfectly appropriate to limit the manner of competition in order to achieve legitimate supervisory objectives such as maintaining safe operating conditions or preventing undue conflicts of interest.

14. Capital Adequacy of Investment Banks

> As investment banking firms become more actively engaged in providing high risk capital such as huge bridge loans for takeovers and LBOs, how should the system for evaluating their own capital adequacy change? Is our current surveillance in this regard adequate?

Ideally, capital adequacy should be measured both at the broker-dealer level and on a consolidated holding company basis. To help prevent market instability, the Commission needs to understand the current financial condition of major firms, including their overall capital and liquidity position. This parallels the ability of banking regulators to review the overall condition of a bank holding company, rather than limiting examination solely to actual banking subsidiaries.

Traditional capital rules may not be sufficient to assess liquidity risks, which could be the most damaging to systemic stability. However, specific changes in current practices must be carefully weighed to determine that significant supervisory improvements will justify increased compliance costs.

15. Enforcement

> What additional steps should the SEC take to prevent what appears to be rather widespread fraudulent and manipulative activity?

I do not personally know how "widespread" fraudulent and manipulative activity is in the marketplace as a whole. The Commission should continue vigorous efforts to combat insider trading, and it should monitor SRO enforcement of rules against front-running practices as described in response to an earlier question. International enforcement cooperation should be strengthened, and the Commission should continue vigorous efforts to combat penny stock fraud through rulemaking, information sharing, criminal referrals and other techniques.

One example of the Commission's resolve to take necessary actions to enhance enforcement is the penny stock fraud area. As of August 1, 1989, the Commission had brought 46 enforcement actions in this area compared to 25 actions in all of FY 1988. The Commission also is making more criminal referrals to U.S. Attorney's offices and assisting the FBI and various U.S. Attorney's offices in their criminal investigations of penny stock fraud.

16. Enforcement

> Do you believe that the securities laws currently provide adequate penalties for securities law violations?

No. Under current law, the Commission has the authority to seek civil money penalties only in three limited circumstances. First, civil penalties may be obtained from persons who engaged in insider trading or who controlled a person who engaged in insider trading under the Insider Trading Sanctions Act of 1984 and the Insider Trading and Securities Fraud Enforcement Act of 1988. Second, under recent amendments to the Foreign Corrupt Practices Act, the Commission may seek civil penalties against an issuer and/or certain persons acting on behalf of an issuer who violate Section 30(a) of the Exchange Act. Third, under Section 32(b) of the Exchange Act, issuers may be assessed a civil penalty for failure to file certain required information.

The authority to impose substantial civil money penalties for other types of securities laws violations would be beneficial

to the Commission. While injunctive relief remains a powerful tool, the potential of serious fines could serve as a powerful deterrent to unlawful activity, especially in certain types of cases. Indeed, at present the Commission does not have as much flexibility in imposing civil money penalties as several of the self-regulatory organizations that it oversees. In addition to expanded civil money penalty authority, I believe that giving the Commission cease and desist authority comparable to that of the bank regulatory agencies should be carefully explored.

17. Enforcement

> What are your views on self-regulation and the ability of the securities industry to police itself? How might the self-regulatory apparatus be improved?

In considering a self-regulatory system when promulgating the Exchange Act, Congress attempted to balance the possible dangers of total industry self-regulation (i.e., lax enforcement and conflict of interest concerns) against the perceived ineffectiveness of wide-scale government regulation. Under the Exchange Act, the SROs exercise authority subject to Commission oversight. This is designed to ensure that the SROs meet their obligations regarding investor protection and the public interest.

The degree of supervision exercised by the SROs in the securities markets is largely unique in financial regulation generally. With an ability to pay more competitive salaries than government, the SROs have a better ability to maintain a sufficiently large and experienced staff than the Commission. In addition, the working relationship between the Commission and the various SROs seems to be generally very good, with the result that surveillance and investigatory programs of the SROs have improved as a result of Commission suggestions as well as other input.

Although the tradition and record of the self-regulatory approach has been good, improvements can always be made. It is important for the Commission and the SROs to maintain a high degree of consultation and cooperation in determining the best possible means of achieving supervisory goals.

18. Enforcement

> The press has widely reported the fact that Federal prosecutors are investigating possible theft, money laundering and kickbacks in the stock-loan departments of a number of major brokerage firms and that one of the largest is expected to plead guilty

and cooperate with the Government shortly. What can you tell us about your understanding of how these schemes work? How serious are they? What steps do you plan to take to curtail future abuses?

Stock loan abuses take two distinct forms. The first is embezzlement by employees of a broker-dealer of stock loan fees a firm receives in the form of rebates. This illegal activity often occurs in conjunction with stock loan finders -- persons who locate securities for a fee at the request of a borrowing broker-dealer. The second is the illegal lending by broker-dealers of customer fully-paid securities and/or excess margin securities in violation of Rule 15c3-3 (the customer protection rule). The end result of this violative activity is that customer securities that should be in segregation have been lent, without the customer's knowledge or approval, to another broker-dealer for the securities' cash market value. In some cases this occurs without adequate credit behind such loan.

The funds obtained by converting customer securities into cash could easily be placed at risk by the broker-dealer. Expending this cash on proprietary trading with the accompanying market risks or on payment of salaries are two examples of that risk. If at a later time the broker-dealer is unable to make its customers whole, the liquidation of the firm may be necessary, along with the concurrent harm and financial loss to S.I.P.C., to the investing public and to confidence in the overall market.

Illegal stock loan activity is a serious abuse. Employees who steal money from broker-dealers have no place in an industry that acts as a custodian for customer funds and securities. These employees also present a threat to the financial well-being of the embezzled broker-dealer. The integrity of the marketplace and the protection afforded the investing public are jeopardized by the illegal practice of a broker-dealer who uses customer fully paid and/or excess margin securities for stock loan purposes.

To combat this problem, the Commission (along with the SROs) should maintain a highly trained and experienced broker-dealer examination staff. Examiners should regularly audit for stock loan abuses, and the Commission should actively take enforcement measures in this area, including making criminal referrals wherever appropriate.

19. Failure to Supervise

Over the past few years there have been significant violations of law involving hundreds of millions of dollars. What is your understanding of the failure to

supervise laws and under what circumstances do you believe such a case should be brought by the Commission?

The system of self-regulation for the securities industry established by the Exchange Act places heavy reliance on effective supervision by the firms and their supervisory personnel over branch office operations and personnel. Section 15(b) of the Exchange Act, at paragraphs 4(E), for broker-dealers, and (6), for associated persons, provides the Commission with the authority to bar, suspend, censure or otherwise limit the activities of firms or employees for such failure to supervise others who violate the law. Firms and their supervisory personnel may defend against charges of failing to supervise persons subject to their supervision by proving that reasonable supervision had in fact been exercised, notwithstanding an employee's violation of the Act.

Last year Congress also concluded that more specific supervisory prescriptions that would complement Section 15(b)(4)(E) were necessary to prevent the misuse of material, nonpublic information. The Insider Trading and Securities Fraud Enforcement Act of 1988 creates as new Section 15(f) of the Exchange Act a "new affirmative statutory requirement for broker-dealers and investment advisers to establish, maintain and enforce written supervisory procedures to prevent the misuse of material, non-public information." The legislation also provides in new Section 21A for substantial civil money penalties for control persons based on violations of insider trading prohibitions by persons subject to their control (e.g., employees).

The Commission should be prepared to bring cases where it appears that persons in authority in firms have not exercised vigilance when irregularities come to their attention. This may include cases involving patterns of (i) failure to identify or follow indications of wrongdoing, (ii) failure to ensure compliance with remedial instructions; or (iii) inappropriate reliance on branch office personnel to carry out supervisory functions. In general, it is important for the Commission to review the adequacy of internal procedures and systems for supervision.

20. Failure to Supervise

What is the responsibility of the self-regulatory organizations to bring failure to supervise cases.

Under the Exchange Act, the SROs are required to enforce their own rules, as well as the securities laws in general.

Thus, all SROs have a responsibility to enforce their rules regarding supervision.

To the extent that a member firm fails to supervise reasonably the activities of its employees, the firm is violating a rule of the exchange or association, and disciplinary action may be warranted. The various SROs are expected to review supervision in any significant matter involving violations of its rules or of the securities laws.

21. Failure to Supervise

> If a brokerage firm learns of alleged employee misconduct, what obligations do you believe that firm has under the law?

Section 15(b)(4)(E) of the Securities Exchange Act, and various rules of the NASD and the exchanges impose on broker-dealers a responsibility to supervise the activities of their employees for compliance with the securities laws. A firm's responsibilities include following up on customer complaints, reviewing transactions effected by all employees for possible irregularities, and taking corrective action when violations are discovered. In addition, when a firm terminates an employee because of the employee's violation, it must notify the NASD or exchange of the termination and the reason for the termination. See, e.g., NASD Manual, Article IV, Section 3.

22. Crash and Market Reform Issues

> Are there any measures that Congress and/or the Commission should take to forestall another market break like that in October 1987?

Following the market break of October 1987, the Commission submitted proposed legislation on market reform, which Congress has not yet acted upon. This legislation included useful proposals for enhanced authority to develop an integrated clearance and settlement system; reporting requirements for affiliates of broker-dealers concerning certain financial and operational risks; and large trader reporting requirements.

More comprehensive systems for assessing and controlling liquidity and other risks for both direct market participants and their holding companies, and better coordination between stock and futures exchanges and regulators would create a stronger system.

The implementation of "circuit breakers" between securities and futures exchanges is one example of a new mechanism to protect against market instability. Other desirable systems improvements would include enhancements to permit higher

capacity, increased flexibility and better performance in processing trades. Many such enhancements have been made, or are under way, by the NYSE and other exchanges.

23. Crash and Market Reform Issues

> In addition to the recommendation that one agency should coordinate regulatory issues which have an impact across related market segments, other Brady Commission recommendations following the October 1987 market crash were as follows:
>
> i. Clearing systems should be unified across marketplaces to reduce financial risk. Has enough been done to unify clearance systems?

I do not agree that there should be a single agency to "coordinate regulatory issues ... across related market segments." Effectively regulating cross-market issues would be extremely difficult if the agency performing this function did not have the expertise obtained from regulating the underlying market.

I do not believe that enough has been done to unify or improve clearance systems, although improvements have been made. For example, more rapid settlement and cross-margining should be considered.

> ii. Margins should be consistent across marketplaces to control speculation and financial leverage. What are your views on who should set margin requirements, and the need for them?

Margin plays a somewhat different role in futures markets than in securities transactions. Therefore, uniformity of margin requirements may not be necessary. However, margin levels should ideally reflect prudential considerations as well as the private purposes margin serves. However, any decision to revise the structure of regulation of the futures exchanges, including margin-setting authority, should be made by Congress, not the Commission.

> iii. Circuit breaker mechanisms. What are your views on the need for circuit breakers and the efficiency of circuit breakers currently in place?

I believe the development of "circuit breaker" mechanisms promotes market stability. However, I do not have any basis for

judging the efficiency of the mechanisms and procedures now in place. To my knowledge, only one of these mechanisms (the NYSE's Individual Investor Express Delivery Service) has been activated in the securities markets, and this system has not reported any difficulty. The Division of Market Regulation needs to monitor actively the initial design of circuit breakers, their periodic simulated testing and enhancements as necessary.

> iv. Information systems should be established to monitor transactions and conditions in related markets. It is currently easier to track information relating to commodities trades than it is securities trades. What is your view on giving the SEC more authority over large trading reporting.

I believe that the large trader reporting rulemaking authority would assist the Commission in its surveillance of U.S. markets. Comparable authority has proven beneficial in futures markets, and would help the Commission detect manipulative and other abusive trading activities. However, the cost and competitive impacts of any specific proposal would require careful analysis before action is taken. I would work closely with industry to determine the least costly or disruptive means of achieving the Commission's objectives prior to taking action to implement any specific proposal.

24. Crash and Market Reform Issues

> Suppose the day after you take office the market drops 500 points. Please tell us in the greatest possible detail exactly what steps you would take during and at the close of that day to restore investor confidence in the market and prevent it from falling further. With whom would you consult? In what order? What questions would you ask? What statements would you issue? What actions would you order or encourage other parties to take?

It is not possible to respond to this question without the specific facts surrounding the hypothesized market fall of 500 points. My actions would be affected by such facts as volume and price movements in other domestic and international markets, operability of data processing and other systems, status of clearing houses and their members, conditions in domestic and international futures markets, liquidity conditions for major firms, specialists and other market participants, and possible causes for the market fall. At a minimum, however, substantial market volatility would require the Chairman and his staff to

remain in close touch with the NYSE, NASD and other exchanges, heads of major securities firms, other financial agencies (including the CFTC and Federal Reserve), major foreign securities regulators and key Administration officials, including the Secretary of the Treasury.

25. Crash and Market Reform Issues

Would there come a point at which you might consider closing the market? What point might that be?

No. The Chairman of the Commission does not have the independent authority to "close the market," and I would not consider such a step. While the President does have this authority for securities markets, it has never been exercised. Discretionary authority to close the market has the disadvantage that market participants do not have any means of knowing how or when such authority might be utilized. In a crisis, this uncertainty and the related rumors concerning its likelihood could have seriously adverse consequences.

Nondiscretionary circuit breakers have been developed to respond to market instability by creating planned trading halts. These brief, pre-determined intervals will allow traders and others to assess market conditions and redress operational or financial problems. At the same time, all market participants would know that the markets would shortly reopen to permit market participants to execute transactions they deem appropriate.

26. Crash and Market Reform Issues

Suppose the market continues to drop the next day and eventually bottoms out 800 points below its level when you took office. Would this second market crash lead you to reconsider any of your conclusions regarding appropriate legislative and regulatory responses to the first crash. If so, which ones?

Please see my answers to Questions 24 and 25.

27. Individual Investor and Investor Confidence

Some observers have suggested that small investors may be deterred from entering the market by a perception of widespread fraud and insider abuse. These observers maintain that this perception comes about because, in regulating the securities industry, the Commission has too often contented itself

with reasonable assurances of fraud, rather than insisting on a higher, fiduciary duty. Do you agree that the Commission should insist that market participants adhere to a fiduciary duty in executing transactions on behalf of investors? What specific steps will you take as Chairman to correct the perception that the Commission is satisfied with a lower standard of care?

There are many factors, including competition from other types of investments, that affect individual investor participation in the market. I do not believe that there is a perception that the Commission tolerates fraud or violations of fiduciary duties. Indeed, the securities laws and rules impose strict standards in this area, which the Commission assiduously enforces.

A contribution factor is that the process of investing is unfamiliar to many Americans. Stock investments may be perceived as inconvenient and unduly risky due to price volatility or other factors. Many Americans may also have a perception that self-interest and corruption among securities industry participants are widespread. The Commission can help correct this perception through vigorous enforcement, but much of this change must be accomplished by the industry itself through renewed attention to retail customers and dedication to ethical business practices.

28. Private Placements

Private placements of securities in the United States have increased from approximately $16 billion in 1980 to $200 billion last year, constituting 42 percent of all corporate financing. What steps, including new regulations, should be taken to prevent abuses of the private market and what plans, if any, do you have for ensuring that private placements comply with existing laws and regulations?

The SEC has been considering for some months proposed Rule 144A which would facilitate private trading of securities in the secondary market without SEC regulation. The Commission originally proposed a very broad rule and has since narrowed its proposal. Are you familiar with the proposal and, if so, what is your view as to its advisability and its consistency with the SEC's obligation to protect the investing public?

While I do not presently know of any reliable information concerning significant abuse with private placements warranting new regulations, I would of course be alert to any such suggestion. I am aware of proposed Rule 144A, and I think that its objectives are generally sound.

29. Long-Term Versus Short-Term Investment

> What steps, if any, do you think should be taken to encourage long-term investment? Do you see any problems with the short-term horizon of many pension fund managers and investors?
>
> How do you respond to concerns expressed by many people that our markets have become too speculative and volatile and that this is adversely affecting the long-term planning and research and development plans of corporate America?

Long-term investment is vitally important to our capital markets and to our economy. Long-term capital formation should be strongly encouraged, with greater national emphasis on all forms of savings. While there may have been a shift in emphasis from long-term to short-term returns among some portfolio managers, as to at least some portion of their assets under management, the causes for any such shift should not be oversimplified. Any corrective measures would have to be carefully and thoroughly analyzed for their impact. While most specific proposals for legislative and regulatory change in this area are outside the Commission's direct area of responsibility, legislative or regulatory steps that would create incentives for long-term investment perspectives would be desirable.

I am not aware of any empirical evidence correlating volatility in securities market pricing to corporate R&D expenditure levels. However, to the extent that some institutional investors focus on short-term trading strategies rather than on the economic fundamentals of particular stocks, such investors might respond less favorably to expenditures such as R&D that are designed to enhance long-term corporate earnings capacity.

30. Accounting and Auditing

> The Commission has considerable authority over the accounting industry. Do you believe the SEC should take a more active role in the process of setting generally accepted accounting principles? Do you believe that accountants share part of the responsibility

for the problems of the thrift industry as a result of their poor audit and accounting performance?

Although I do not believe the Commission should set generally accepted accounting principles, the Commission has an interest in reviewing the relevance of accounting standards to providing accurate disclosure to investors, and the impact of accounting standards on U.S. competitiveness. Therefore, I believe the Commission should retain its authority to override, supplement or otherwise amend the standards established by professional accounting bodies.

Individual accounting firms may share responsibility for problems of individual failed thrifts. However, in my view the ability of the Federal Home Loan Bank Board ("FHLBB") to establish its own "regulatory" accounting principles was a greater accounting problem in the thrift industry. The FHLBB's ability to adopt accounting standards that overstated significantly the net worth of many thrifts was possible in large part due to the exclusion of thrifts and securities issued by thrifts from the Securities Act and the Exchange Act. In my opinion, oversight of such matters by the Commission, rather than the FHLBB, would have resulted in stronger accounting rules for thrift institutions.

31. Accounting and Auditing

Do you believe that certified financial statements provide reasonable protection to investors? If not, what additional steps should be taken by independent auditors to protect investors?

Yes. Standards should of course be updated and improved as necessary to meet changing business and economic trends.

32. Accounting and Auditing

Under what conditions, if any, should accounting firms be permitted to have direct business relationships with their audit clients? How should the independence of the audit be maintained?

This is a difficult question involving balancing the need for a truly independent auditor and with the need to avoid interfering unnecessarily in the provision by accounting firms of other types of services to their audit clients. I do not wish to take a specific position until I have an opportunity to review the work of the Commission staff on its existing study of this issue.

33. Accounting and Auditing

> Book value accounting with its historical cost basis has been blamed for many things. Some say that manufacturing and commercial companies have been subject to takeover leveraged buy-out offers from management insiders because management has a true idea when depreciated assets are undervalued and future liabilities are not discounted to present value. On the other hand, banks and thrifts have used book value accounting to hide problem assets until the problems become overwhelming. In general, do you believe that securities disclosure should include market based valuations? Also, specifically, do you support the Statement of Policy issued by the Federal Home Loan Bank Board on May 19, 1989 that would require thrifts to at least disclose the market value of assets that are held for purposes of a later sale or trade (as opposed to assets held to maturity)?

Market value rather than historic cost valuation is an important element in understanding the condition of financial institutions. However, the question of market value accounting and disclosure is complex, and the FASB is studying cost, reliability and other issues that should be carefully analyzed. In some cases it may be desirable to report historic costs and market values in parallel. I have not reviewed the detailed provisions of the FHLBB policy statement, but I support a movement toward mark-to-market accounting (already used by securities firms) by banks and thrifts.

34. Accounting and Auditing

> The large accounting firms that audit most public companies are rapidly merging. The "Big 8" may now become the "Big 5." Should the Commission be concerned with declining competition, excessive size, audit quality or any other implications of these mergers?

I believe the implications of these mergers would be more appropriately addressed by federal agencies with antitrust responsibilities, such as the Department of Justice.

35. Accounting and Auditing

> What have you learned about the accounting industry from your active involvement in dealing with the problems of the thrift industry?

The problems of the thrift industry demonstrated the danger of allowing bank or thrift regulators to determine the degree of financial information that would be disclosed by regulated institutions as issuers of securities, or the specific accounting principles to be followed. I have not formed an opinion regarding the accounting industry itself as a result of this experience.

36. Jurisdiction over Securities Issued by Banks and Thrifts

> Currently, Section 12(i) of the 1934 Act places securities issued by banks and thrifts under the separate regulatory structure for such institutions. Do you think that 12(i) should be repealed with regulation of all securities centralized at the SEC?

Sections 3(a)(2) and 3(a)(5) of the Securities Act exempt securities issued by banks and thrifts from registration requirements, while Section 12(i) of the Exchange Act places responsibility for reporting as a public company in the respective bank and thrift regulatory agencies, rather than the Commission. The result is that five different agencies have authority over the disclosure practices of banks and thrifts or bank and thrift holding companies. This situation reduces protection for investors and increases overall costs to the Federal Government. I strongly believe that repealing the bank and thrift exemptions of Sections 3(a)(2), 3(a)(5) and 12(i) would significantly improve disclosure to investors and to the market. In my opinion, the result would be a stronger and more effective regulatory system, at less expense to the Federal Government.

37. Municipal Securities

> Should the exemptions in the securities laws related to issuers of municipal bonds be continued or should such issuers be subject to the same regulation as issuers of other types of securities?

I do not have an opinion as to the cost effectiveness or constitutionality of any such proposal. Investors in municipal securities generally need reliable financial data as much as investors in other types of securities. The Commission recently

has clarified that the anti-fraud provisions of the securities laws impose a duty on municipal securities underwriters to be confident of key representations made in the issuer's official statement. In addition, the Commission adopted Rule 15c2-12, which ensures availability of the official statement to investors and financial analysts and requires access by underwriters to that document prior to bidding for those securities. The effect of these actions should be carefully monitored prior to additional regulatory or legislative action.

38. Soft Dollars

> Do you believe that the practice of payment for order flow with hard and soft dollars, which was recently the subject of an SEC roundtable session in July, is detrimental to the industry?
>
> If so, how do you believe that the practice should be regulated, given the fact that Section 28(e) of the Exchange Act specifically permits certain "soft" dollars practices by money managers?
>
> Should the Commission consider banning the practice in any respect?

I have not formed any specific opinion on this issue. I do not believe that any conclusions as to the advisability of regulations or legislation in this area should be reached until the empirical surveys that the Commission's staff and the SROs are now preparing as to the extent of these practices are available.

39. Corporate Governance Procedures

> As more and more corporate shares are held by major institutional investors such as pension funds, what specific changes in corporate governance procedures would seem appropriate?

Corporate governance procedures generally are matters for state law, with exceptions such as the proxy rules, among others. While the trend toward equity ownership by institutional investors may raise new issues concerning voting confidentiality and fiduciary standards, I am not prepared to support any specific changes in federal law applicable to corporate governance procedures at this time. However, I would also plan to review carefully analysis of this issue from the Commission, commentators, the American Law Institute and others.

40. Trading Systems

> Many people believe that the trading systems of the future will be fully automated along the lines of London and Tokyo. What is your view of the trading system of the future?

It is a misperception that either the London or Tokyo markets is "fully" automated. The International Stock Exchange in London adopted, at the time of "Big Bang," a screen-based quotation dissemination system modeled after the National Association of Securities Dealers' NASDAQ system. Trades in that market largely are still negotiated over the telephone, however, as they are in the U.S. over-the-counter market.

The Tokyo Stock Exchange ("TKE") introduced an automated order routing and execution system called the Computer-Assisted Order Routing and Execution System ("CORES") in 1982. CORES provides facilities for the electronic entry of orders from member firms' offices, display of the contents of the limit order book and execution of matching orders. This occurs either automatically or through manual entry by "saitori," who are TKE members that function somewhat like specialists on U.S. exchanges. Approximately 90% of the domestic stocks and all foreign stocks listed on the TKE are traded in CORES. The 150 stocks not traded in CORES, however, are the most actively traded and account for approximately 75% of total TKE share volume.

In the United States, both traditional exchange markets and screen-based systems are used actively. I cannot project what type of system will prove most dominant in the future, although both types of systems are likely to continue to evolve.

41. Disclosure

> Do you believe that the current disclosure requirements for American corporations are effective and efficient? What disclosures, if any, would you reduce or eliminate? Are there areas in which disclosure is insufficient to properly inform investors? Do you believe that investors would be better informed if market based valuation was more widely applied? Should mark-to-market financial statements be prepared as a supplemental to existing book value statements?

Yes, I believe that the current disclosure requirements for American corporations are both effective and efficient, although they can always be improved. These disclosure rules provide comprehensive information as to a company's business, financial

condition and securities. Obviously no system is perfect, and the Commission should continuously review its disclosure policies in light of market developments.

42. Functional Regulation

> You have been a strong advocate of "functional regulation" in the financial services industry but this concept has been criticized by a number of people.
>
> For example, in a speech to be delivered November 2, 1989, former SEC Enforcement Chief, Judge Stanley Sporkin calls the concept "unworkable" in the enforcement area. In advocating a single enforcement arm in the financial services regulatory scheme he writes:
>
> The rationale behind a single enforcement arm is to assure that an organization that is dealing in a multitude of products will be precluded from operating where it is not acting responsibly in any of its various business phases. This concept would in effect recognize that functional regulation simply is unworkable. What did not make sense to me when I was Director of Enforcement at the Securities and Exchange Commission was that when we discovered a brokerage firm was cheating its securities clients we were without jurisdiction to examine the firm's non-securities operations. It was obvious to me that a firm that would churn a customer's securities account would do likewise with respect to that customer's commodities transactions. This jurisdictional impediment made us at the SEC look like a bunch of Inspector Clousseaus.
>
> If the regulated are able to cross functional lines, the regulators should be able to do the same. So for those who advocate functional regulation, I suggest they consider that view. It would only perpetuate the Balkanization that now exists.
>
> What is your reaction to this criticism of functional regulation by Judge Sporkin?

I do not believe the Enforcement Division of the SEC has ever looked like a collective group of "Inspector Clousseaus,"

and certainly not under Judge Sporkin. "Functional regulation" is a term that is used by different people to describe vastly different concepts.

Law enforcement in this country is not generally unified in a single agency, but rather is divided by geographic jurisdictional boundaries as well as specific "functional assignments" (drugs, customs, etc.). In a decentralized society, our financial regulation as well as our entire political system will always have jurisdictional boundaries among agencies and governmental units. Coordination and cooperation among all financial agencies should be active, including authority for agencies to bar persons convicted of fraud or wrongdoing in other financial sectors. Indeed, in appropriate cases the Commission should also refer information regarding potential violations to the U.S. Attorney, the FBI, state law enforcement or to other regulatory agencies. In general, I believe enforcement can be effective notwithstanding jurisdictional boundaries.

43. Tender Offers

> Since the junk bonds and corporate notes the Goldsmith Group is offering will not be listed on the London Stock Exchange, they will not be subject to regulatory review in the United Kingdom. If the SEC does not require registration of the securities, there will be no regulatory review here. Is it not troubling that the second-largest tender offer in history will not be reviewed on either side of the Atlantic for its effect on U.S. shareholders of B.A.T. Industries?

I have been informed that, based on a careful review of all relevant facts, the Commission's staff has concluded that the registration requirements of Section 5 of the Securities Act have not been triggered by the offer in question. In addition, the staff has concluded that the Commission does not have any regulatory jurisdiction over this offering under any other provision of the federal securities laws.

The Commission should not take action in cases where it has determined that it does not have jurisdiction. Indeed, imprudent attempts to assert jurisdiction over offshore transactions could lead to counterproductive foreign assertions of jurisdiction over capital market transactions within the United States.

Foreign issuers making an exchange offer of this kind frequently do not extend offers to U.S. holders because they are unwilling to bear the costs and other burdens of registering securities in the United States. The U.S. securities laws and the principles of international comity would not permit the

Commission to force a foreign issuer to enter the U.S. securities markets against its will, even though U.S. investors may be excluded from investment opportunities.

44. Foreign Ownership

> Should the SEC or any Federal government authority take steps to monitor the increasing foreign ownership of American industry?
>
> Are you at all concerned about increasing foreign ownership of American industry?

Foreign investment in the U.S. has helped to provide capital to support the construction of facilities in the U.S. that have increased production and employment since the earliest days of our nation. The disclosure requirements of the federal securities laws apply to foreign ownership interests in shares of publicly-held U.S. companies, as such requirements apply to domestic holdings. Beyond enforcing current disclosure requirements, I do not believe the Commission should have any responsibility for "monitoring" foreign ownership of assets located in the United States.

45. Public Utility Holding Company Act

> You are no doubt aware that efforts to secure the repeal of the Public Utility Holding Company Act several years ago failed. Would you expect to make its repeal a legislative priority for the Commission?

The Commission has a longstanding position in favor of repeal of the PUHCA, or transfer of its responsibilities to a more appropriate agency. I do not anticipate making this issue a priority concern of the Commission, although the fundamental soundness of this recommendation is demonstrated by the consistency of the Commission's views on this subject.

II. Questions from Senator Alan Cranston

46. Multiple Trading of Options

Mr. Breeden, on May 25th of this year, the Securities and Exchange Commission adopted Rule 19c-5, permitting the multiple trading of standardized options on exchange-listed securities. This new rule is to take effect on January 22, 1990, and would fundamentally alter the manner in which stock options have been traded for the last decade.

The SEC has chosen to pursue this course of action despite strong opposition from a majority of the options exchanges as well as from numerous brokerage firms, both regional and national. In addition, serious reservations have been raised by many in the Congress, including myself, in a number of letters to the Commission.

As these letters point out, the multiple trading of options would entail a major restructuring of a complex component of our nation's overall securities market. Such a step would present several possible serious repercussions for the securities industry and the public investor.

I realize that the answers to some of the more technical questions that have been raised may not be possible to determine until multiple trading has commenced. However, I am greatly disturbed that several basic items, such as a cost/benefit analysis, or safeguards necessary to protect public orders, have yet to be clearly identified.

This Senator believes that the Congress has a duty to ensure that answers to such basic questions as these are provided by the regulators before multiple trading is implemented.

Therefore, Mr. Breeden, I would like to have your assurance that, if confirmed, you will carefully review this entire proceeding to satisfy yourself that the Commission's rule is well-grounded in fact and can withstand

> the close scrutiny that a decision of this nature deserves to be given. Specifically, I would ask that you consider postponing the implementation of Rule 19c-5 until you are able to certify to the Congress that multiple trading can be implemented in a cost-effective manner; that it will not harm the public investor, and that it will not impede the development of a national market system that the Congress has found to be in the public interest.

I am aware that the Commission's action with respect to the multiple-trading of standardized options on exchange-listed securities (Rule 19c-5) is controversial, and that it has raised serious concerns. At the same time, it is worth noting that the Rule was adopted unanimously, based on extensive staff consideration, and more than two years following its initial proposal for comment. As I understand it, the Commission's final action was based on a conclusion that the benefits from the proposal would be significant, while its problems would be small and manageable.

If confirmed, I will carefully review this proceeding to satisfy myself as to the desirability of this rule. I would include in this review consideration of any developments that may have occurred since the Commission's action, such as the degree of movement toward market integration systems. However, I cannot commit that I will recommend any specific action, or that other Commissioners would change their views irrespective of my conclusions.

47. Financial Reform

> S. 530, a bill introduced by Senators D'Amato, Garn and myself imposes a comprehensive approach on reform by setting up a system of functional regulation of all new activities permitted by financial entities rather than a piece meal approach with Congress handing over several powers at a time over many years. In your role as the new Chairman of the Securities and Exchange Commission, how would you recommend that this Committee approach banking reform proposals? i.e., piece meal or comprehensively?

A comprehensive update of financial services statutes would be desirable. I would certainly hope that the Commission could work with the Congress to outline a blueprint for comprehensive change. However, I would also favor enactment of specific, targeted reforms while awaiting "comprehensive" legislation where such narrower reforms would be consistent with broader objectives.

III. Questions from Senator Christopher J. Dodd

48. Over the years, this committee has had a very constructive working relationship with the Commission and the Commission staff. Senators, as well as our staffs, have felt free to call and talk with any of the individual Commissioners. We have had the Commission staff come to the Committee on many occasions for informal meetings, often on short notice, to provide information we may require on fast-breaking problems. The Commission staff routinely provides technical assistance on legislation. Will you continue to support and encourage these practices without restriction?

I will continue current practices in this area, as I believe that a full exchange of views between the Commission and Congress is a healthy process.

49. From time to time, we have requested and received from the Commission documents -- internal, nonpublic documents -- which we review and discuss with the Commission and its staff as part of our oversight function. Will you continue to support that practice?

I am not familiar with specific practices in this area, so I cannot make any specific commitment. However, I appreciate the significance and importance of Congress' oversight responsibilities.

50. Describe, in your own words, what you believe the relationship of the SEC should be:

- to the White House?
- to OMB?
- to Congress?

The Commission should be a source of expertise, analysis and policy advice for the White House, OMB and Congress, all of which have an interest in the issues relating to U.S. capital markets and the federal securities laws.

51. You have pointed out to a number of people that you are the President's personal choice for SEC Chairman. What steps do you intend to take to ensure that you avoid even the appearance of compromising the independence

of the SEC or being overly influenced by your relationship to the President or to your former colleagues in the Administration?

The President selects all nominees to the independent commissions. If confirmed, I intend to carry out my responsibilities fully, and without partiality of any kind.

52. If you are confirmed, what are your priorities for the SEC?

If confirmed, my first priority will be to maintain, and hopefully to enhance, the tradition of excellence of the Commission in its staff, and the professionalism of its work product. The Commission represents an institutional resource of extreme value to the capital markets of the U.S., and to the protection of investors.

Among my other high priorities will be to:

- improve the capacity of the Commission, working with other national securities regulators, to reduce risks and improve stability in global capital markets. This requires improvements in clearance and settlement systems, market surveillance, capital standards and mutual enforcement cooperation;

- help enhance the international competitiveness of U.S. markets and the ability of issuers to raise capital in the U.S. at the lowest possible cost; and

- prevent or detect and prosecute financial fraud and manipulation of all types, to maintain the honesty and integrity of markets.

53. In June of 1988, the SEC submitted to Congress legislation developed after its review of the October 1987 market break. Senators Dodd and Heinz introduced the legislation earlier this year as S. 648, the Market Reform Act of 1989. Section 4 of the bill, Risk Assessment for Holding Company Systems, would give the SEC authority to request information concerning the financial and operational condition of broker-dealer holding company systems. Do you feel that such an expansion of SEC jurisdiction is needed and, if so, for what reasons?

The stability of broker/dealer firms is increasingly indivisible from the financial condition of the entire company of which a broker/dealer is a part. Sudden collapse of a broker-

dealer's parent firm could cause nearly instantaneous collapse of the broker/dealer's liquidity resources, with potentially enormous impact on the integrity of the market. Therefore, I believe that it is imprudent for the Commission to be unable to determine the degree of risk of such circumstances, and the threat they represent to investor confidence and the financial system as a whole.

54. The large trader reporting provision in S. 648 provides the Commission with the authority to adopt reporting rules for large transactions in publicly traded securities and related transactions in equity index futures and options on such futures. Various industry members have argued that the SEC now has ready access to information about large traders through cooperative SEC-self regulatory organization efforts, such as the electronic blue sheets. Do you believe that this new reporting requirement is needed?

Yes, I believe this authority would be useful to the Commission for use in both enforcement investigations and also in monitoring market trends and conditions to maintain stability. Carefully constructed actual rules should prevent any undue cost or interference to reporting firms.

55. S. 648 would give the SEC emergency authority to suspend all trading in U.S. securities markets. Do you support this section of the legislation?

No, I do not believe that authority of this nature should be vested in the Commission.

56. Section 5 of the Market Reform Act of 1989 would direct the SEC and the CFTC to facilitate the establishment of linked, coordinated, or centralized facilities for clearance and settlement of transactions in securities, options on securities, financial and commodity futures, and options on such futures. Do you support this measure? In light of existing tensions, how would you facilitate a cooperative environment between the SEC and the CFTC and work to implement the obvious need for improved clearance and settlement?

Yes, I believe coordinated and enhanced clearance and settlement mechanisms are very important. I intend to work diligently to create an environment of close cooperation with

the CFTC in every area of mutual concern. Hopefully this measure could also promote progress toward a safer and more competitive system in both securities and futures markets.

57. The SEC's settlement with Drexel Burnham Lambert gives the SEC substantial authority to shape the management of the firm and conduct continuing oversight over some aspects of its operation.

In general, would you be willing to support those kinds of sanctions against securities firms in the future?

Yes, the Commission has made specific management changes or policies a part of settlements in other cases as well. While as a regular matter the Commission should not seek to dictate actual management of a firm, extraordinary corrective action must be an option where a firm has shown a pattern of sustained and widespread misconduct.

58. What are your views generally on the appropriateness of a "failure to supervise" sanction? Under what circumstances would you support such a charge against an officer of a broker-dealer?

The system of self-regulation for the securities industry established by the Exchange Act places heavy reliance on effective supervision by the firms and their supervisory personnel over branch office operations and personnel. Section 15(b) of the Exchange Act, at paragraphs 4(E), for broker-dealers, and (6), for associated persons, provides the Commission with the authority to bar, suspend, censure or otherwise limit the activities of firms or employees for such failure to supervise others who violate the law. Firms and their supervisory personnel may defend against charges of failing to supervise persons subject to their supervision by proving that reasonable supervision had in fact been exercised, notwithstanding an employee's violation of the Act.

Last year Congress also concluded that more specific supervisory prescriptions that would complement Section 15(b)(4)(E) were necessary to prevent the misuse of material, nonpublic information. The Insider Trading and Securities Fraud Enforcement Act of 1988 creates as new Section 15(f) of the Exchange Act a "new affirmative statutory requirement for broker-dealers and investment advisers to establish, maintain and enforce written supervisory procedures to prevent the misuse of material, non-public information." The legislation also provides in new Section 21A for substantial civil money penalties for control persons based on violations of insider trading

prohibitions by persons subject to their control (e.g., employees).

The Commission should be prepared to bring cases where it appears that persons in authority in firms have not exercised vigilance when irregularities come to their attention. This may include cases involving patterns of (i) failure to identify or follow indications of wrongdoing, (ii) failure to ensure compliance with remedial instructions; or (iii) inappropriate reliance on branch office personnel to carry out supervisory functions. In general, it is very important for the Commission to review the adequacy of internal procedures and systems for supervision.

59. The Commission sent to Congress a bill entitled "The Securities Law Enforcement Remedies Act of 1989." It was introduced by Senators Dodd and Heinz at the request of the Commission as S. 647. The bill would create new civil fines for securities law violations, up to $100,000 for individuals and $500,000 for corporations. In certain cases, it would also permit a court, or the SEC in administrative proceedings, to prohibit an individual law violator from serving as an officer of director of a public company or a regulated firm.

Do you support the bill? Do you generally support the proposition of civil fines for securities law violations?

I strongly support the authority for the Commission to levy civil fines for securities law violations. While injunctive relief remains an important enforcement remedy, civil money penalties would be a significant deterrent to wrongdoing by enabling the Commission to create economic risks to those who violate the securities laws. If anything, I am not certain that the maximum levels permitted under the proposed legislation would be sufficient in extremely serious cases.

60. The SEC is best known for its high-profile insider trading cases. Are there other areas of enforcement -- for example, accounting fraud, municipal securities regulation, or other areas -- that you believe should get greater attention? Where do you see the greatest harm to investors?

Threats to investors may come from a variety of directions, and I believe that the Commission has to be vigilant and alert to all such problems, irrespective of their source. The penny stock

problem deserves special emphasis due to the often severe impact of such cases on individual investors. Market manipulation should also be the subject of careful surveillance and enforcement action.

61. Do you have an opinion about how well self-regulation in the securities industry is working?

In considering a self-regulatory system when promulgating the Exchange Act, Congress attempted to balance the possible dangers of total industry self-regulation (i.e., lax enforcement and conflict of interest concerns) against the perceived ineffectiveness of wide-scale government regulation. Under the Exchange Act, the SROs exercise authority subject to Commission oversight. This is designed to ensure that the SROs meet their obligations regarding investor protection and the public interest.

The degree of supervision exercised by the SROs in the securities markets is largely unique in financial regulation generally. With an ability to pay more competitive salaries than government, the SROs have a better ability to maintain a sufficiently large and experienced staff than the Commission. In addition, the working relationship between the Commission and the various SROs seems to be generally very good, with the result that surveillance and investigatory programs of the SROs have improved as a result of Commission suggestions as well as other input.

Although the tradition and record of the self-regulatory approach has been good, improvements can always be made. It is important for the Commission and the SROs to maintain a high degree of consultation and cooperation in determining the best possible means of achieving supervisory goals.

62. In the past, the SEC has consistently supported private rights of action as a necessary adjunct to the Commission's enforcement efforts. What are your views?

For at least 25 years, the Supreme Court has permitted private rights of action under the federal securities laws as a "necessary supplement" to Commission enforcement actions. Persons who have been injured by securities law violations often will have the incentive to seek recovery for the violation. Such suits serve both a remedial purpose, and act as a powerful deterrent to violators.

Private actions do not, however, serve all of the ends served by Commission actions. The Commission may be able to sue where no private litigant can or will, and the Commission often

can obtain relief in the public interest that is not generally available to a private litigant. In some areas private actions could be counterproductive, by creating excessive litigation or inconsistency in outcomes. Therefore, private actions supplement the Commission's enforcement program, but they cannot be used in every area, and they do not substitute for a vigorous and well-staffed Commission enforcement program.

63. The SEC has submitted legislation to Congress to create a self-regulatory organization for investment advisers. It was introduced as S. 1410 by Senators Dodd and Heinz at the SEC's request. In general, do you support the legislation?

I have not formed a specific opinion on this legislation.

64. We have marked up S. 646, the International Securities Enforcement Cooperation Act. You stated at your recent hearing that you support the legislation. Are there areas, other than enforcement, in the international arena where coordination is needed?

Yes, there is a great need for more active cooperation in reducing systemic risks, such as by enhancing clearance and settlement systems and developing common net capital rules. There also needs to be a stronger institutional framework for international cooperation in securities regulation. Common, or more closely harmonized, accounting, auditing and disclosure standards would also be beneficial. Finally, mutual recognition agreements can minimize the time and cost to raise capital or conduct transactions in multiple countries.

65. The Bush Task Force recommended removal of the Section 8(A)(2) exemption under the Securities Act and Section 12(i) under the Exchange Act with respect to bank amendment of securities and securities guaranteed by banks, as well as certain securities issued by thrifts. Do you believe there is a need to implement this recommendation?

Yes, this remains an extremely important issue. Unifying regulation of all securities offerings and periodic disclosure under the Commission would strengthen investor protection, provide greater accounting consistency, maximize disclosure and reduce overall costs.

66. What is your view on the impact of "soft dollar" practices on the integrity of the securities markets and market liquidity? Do

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you believe the current scope of Section 28(e) of the Exchange Act should be narrowed? What do you plan, if anything, as a follow-up to the Commission's recent roundtable on soft dollars?

I have not formed any specific opinion on this issue. I do not believe that any conclusions as to the advisability of regulations or legislation in this area should be reached until the empirical surveys that the Commission's staff and the SROs are now preparing as to the extent of these practices are available.

IV. Questions from Senator Alan J. Dixon

67. What are your views on Glass Steagall reform? What securities activities should banks be permitted to engage in? Should they be permitted to underwrite corporate debt and equity securities and to affiliate with firms which do so? If this should be permitted, what regulation would be appropriate? What sort of protective measures would be needed?

In general, I do not favor any arbitrary or artificial restrictions against competition per se. I do believe that it is perfectly appropriate to limit the manner of competition in order to achieve legitimate supervisory objectives such as maintaining safe operating conditions or preventing undue conflicts of interest.

In the past, the Commission has supported repeal of the Glass-Steagall Act, so long as any such repeal is accompanied by the requirement that banks conduct most of their new and existing securities activities in separate affiliates or subsidiaries subject to Commission regulation. I do not disagree with this position. However, I believe that other reforms would have to be made at the time of any change in Glass-Steagall, including significant modification of the Bank Holding Company Act and specific standards relating to conflicts of interest.

68. How should we protect against potential conflicts of interest from the combination of securities and other financial activities in a single entity or through a holding company structure? Would disclosure and other securities laws be sufficient? What sort of regulatory restrictions would you find appropriate? What role, if any, would you envision the SEC playing in Glass-Steagall reform?

Preventing conflicts of interest is one of the major topics that must be addressed satisfactorily in any reform of Glass-Steagall. Repeal or substantial alteration of the Bank Holding Company Act is another. I do not believe disclosure laws alone would be sufficient to control conflicts problems, and specific statutory provisions will be desirable.

I believe that it is critically important to achieving a fair, balanced and safe system for the SEC to play a major role in any revision of the current system. The Commission has more

experience with the specific hazards and dangers that might be presented by a new system than any other agency.

Ultimately, a variety of different means ranging from disclosure to specific prohibitions may be necessary to address the many different conflicts issues. However, these conflicts questions also arise under the current system, and I do not believe that they present an insuperable obstacle to modernizing our laws.

69. I am concerned about a recent transaction, affecting Marshall Fields in my home state, which involves dollar-denominated junk bonds offered overseas. This transaction so far has escaped U.S. securities law jurisdiction, even though the junk bonds are expected by many to come to rest in the United States. I am concerned that this transaction, if allowed to go forward unregulated, will provide a model for other foreign companies seeking to escape SEC jurisdiction while still taking advantage of our securities markets. What are your views on this issue.

In general, U.S. securities laws do not and should not cover every issuance of dollar-denominated securities in the world. The Commission's jurisdiction is limited and may not be triggered by many offshore offerings, even where they may involve a control contest that will affect ultimate ownership of assets located in the U.S. This is not conceptually different than a control contest in the U.S., which may affect ownership of assets located in foreign countries whose securities regulators would not have jurisdiction over an offering in the U.S.

An unregistered distribution of securities in the U.S. is unlawful, even if the offer utilizes the device of an overseas distribution unless there is adequate assurance that such securities would "come to rest" outside the U.S. Therefore, the Commission must review the specific facts of any such transaction to determine whether there has been a violation of U.S. law.

70. PUHCA

The SEC has proposed a new regulation that would adversely affect several public utility holding companies in Illinois. Many members of the public utility industry, along with state regulatory utility commissioners, argue that the proposed rule would force costly and unnecessary divestitures, would interfere with traditional federal-state allocation of regulatory responsibility, and would

exacerbate the workload problems of an already understaffed area of the SEC. What are your views on proposed Rule 17, particularly in light of the conclusion of the Task Force on Financial Services Regulation recommending repeal of the Public Utility Holding Company Act?

I am generally aware of the provisions of proposed Rule 17, but I have not reviewed it in detail. I continue to support outright repeal of the Public Utility Holding Company Act, or at a minimum transfer of its responsibilities to a more appropriate agency. If the statute is not repealed, the Commission must enforce its provisions in a sensible and efficient manner. Proposed Rule 17 includes artificial percentage limitations on non-utility businesses that are not set forth in the statute. Such artificial restraints on competition should be intensely scrutinized to determine whether they are absolutely necessary to achieve statutory purposes.

71. Multiple Trading Rule

What are your views on the multiple trading rule and its effect on the regional exchange system?

Rule 19c-5, the rule concerning multiple trading of options on listed securities, was unanimously adopted by the Commission earlier this year. The Commission adopted staff recommendations based on several years of analysis and extensive public comment. The Commission believed that significant benefits will result from the rule, with only a small and manageable adverse impact.

I am aware that this rule is extremely controversial, and that certain exchanges are now working on means to provide market integration facilities. If confirmed, I will carefully review the desirability of this rule. In this review, I would include consideration of any developments that may have occurred since the Commission's action, such as the degree of movement toward market integration systems. However, I cannot promise to recommend any specific action, or that other Commissioners would change their views.

V. Questions from Senator Jim Sasser

72. The Secretary of the Treasury suggested recently that we should change the tax treatment of equity so that the tax code doesn't favor debt over equity. This has been the subject of debate for some time -- the double taxation of dividends. So Mr. Brady wants to lighten the tax treatment of dividends paid to shareholders. This would, of course, tend to favor wealthy individuals, and again, of course, greatly exacerbate the budget deficit.

Well what about changing the tax treatment of debt to make it more expensive? Why should the billions of dollars that are borrowed in leveraged buyouts, which to my mind sometimes benefit very few people, be fully deductible?

We passed a so-called tax "reform" bill in 1986 that mandates that a young person just starting out in his career can't deduct a red cent on his student loans. Yet we have these enormous leveraged deals that are fully deductible.

Forbes magazine estimated that because the debt incurred in the RJR Nabisco LBO was fully deductible, the government lost $5 billion in revenue. That's just one transaction -- $5 billion.

What do you think? Why not limit the amount of debt that can be deducted and raise some money around here, instead of looking for more ways to benefit wealthy individuals?

In general, I do not believe that our tax system should penalize the use of equity capital rather than debt. Unfortunately, unlike most of our major international competitors, the U.S. does not provide any form of relief from double taxation of dividends. The effect of such a punitive policy is to create a strong incentive to replace equity with debt, which is one factor that results in LBO transactions. Indeed, while the cost of debt is generally comparable in the U.S. and in most other markets, the cost of equity capital in the U.S. appears to be significantly higher than the cost of equity in Japan or other competitor nations. This disparity hurts the

long-run stability and competitiveness of U.S. companies, thereby reducing economic growth and job formation.

The penalty applied to use of equity capitalization may reduce the stability of some companies, thereby making it somewhat more likely that their employees, suppliers or communities may be affected by adverse financial conditions. Reducing this type of risk is one reason eliminating the double tax on equity would benefit more people than stockholders alone.

Conceptually, some of the differential also could be eliminated by altering the tax deductibility of acquisition debt. This would of course not eliminate the general penalty against equity capitalization. In addition, such a rule could create significant issues in determining the true use of proceeds from debt issuances. Such a proposal also could have other tax policy consequences.

Obviously formulating tax policy is not the role of the Commission. However, I believe the Commission can perhaps play a constructive role for both Congress and the Administration by working to develop empirical data regarding these issues.

73. Why do we need to go the self-financing route at this time in the reconciliation bill? Wouldn't it be better for this Committee -- the Banking Committee -- to consider this issue carefully instead of trying to ram it through on reconciliation?

And what about the policy here? You have a lot of experience in government. What if every agency tried to earmark federal revenues to itself? We'd have problems raising money for those programs that weren't fortunate enough to have dedicated revenues, wouldn't we?

What makes the SEC so special? This proposal will mean that the SEC will no longer return money to the Treasury. According to one analysis it means that the Treasury could lose over $375 million over the next few years.

I did not participate in the development of the self-funding study that Congress requested the Commission to perform. I have also not participated in the legislative process with respect to the Commission in the reconciliation bill.

There are several good arguments in favor of some form of self-funding for the Commission. The Commission's

responsibilities depend on inherently unpredictable levels of market activity -- such as the number of initial public offerings in a year or the volume of insider trading or other enforcement cases detected by the Commission. Use of a fee system would generally avoid the risk that the Commission's appropriations would prove insufficient to perform its responsibilities -- which are dictated by the level of market activity. In addition, the Commission produces a significant annual budget surplus so that flexibility to respond to market developments and activity levels need not cost the taxpayers anything.

Independence from the appropriations process therefore would give the Commission the flexibility to provide adequate safety examinations and enforcement actions without having to allow serious crimes go unpunished, or forcing examinations and reviews to be abandoned. All of the bank and thrift agencies -- including the Fed, FDIC, OCC, and the new OTS -- are funded with fees rather than assessments. Indeed, the OCC, a part of the Treasury Department, has followed that approach for more than 126 years.

The adverse potential of an appropriations system for financial supervision was demonstrated by the S&L disaster. The use of an appropriations process for many years in determining the number of examiners and other personnel at the FHLBB and FSLIC was a factor in the breakdown in effective supervision, as was the fact that the FHLBB was subject to pay caps that left it at a competitive disadvantage for senior supervisory personnel to the FDIC and Federal Reserve, for example. Inadequate numbers and quality of supervisory personnel was one of the factors that resulted in the greatest loss to American taxpayers in history.

The appropriations process obviously provides valuable Congressional oversight over agency activities. However, this oversight could be provided, as occurs with the FDIC and other banking agencies, without use of appropriations. The issue of returning any surplus fees to the General Fund, as the Federal Reserve now does, is of course entirely separate. There is not any inherent reason why a fee-based funding system could not also result in a surplus to help reduce the overall budget deficit.

74. — Mr. Breeden, we hear a lot today about the need to encourage a longer-term view in our economy. Mr. Darman talks about "now-now-ism." And everyone has their own solution. Secretary Brady thinks we need to do something about the double taxation of dividends. Others say we need a capital gains tax reduction.

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Well, I have problems with these options. Among other things, they are major long-term revenue losers.

What about a revenue raiser -- Yes, a tax -- that might accomplish the same thing. I think we forget that you can have good tax policy and raise revenue.

What about a tax on the stock churning of institutional investors, particularly pension funds? I constantly hear that the fact that pensions own enormous blocks of stock, and are constantly trading them, is a major disincentive to long-term investment -- particularly R & D by companies. Companies are afraid to make any investments that might depress earnings.

Why don't we make them pay a capital gains tax if they don't hold stock for -- say -- three weeks? Right now all their gains are tax exempt -- even if they hold for only 15 minutes.

No less an authority in securities than Felix Rohatyn suggested this type of tax right here last July. Pensions now own half of all the shares traded on the New York Stock Exchange. Some corporations report that pension funds own 80% of their stock. Pensions turnover 70% of their portfolios every year.

I think this is a big part of the short-term perspective problem. Why don't we do something about this and raise money?

The Commission has not taken a position on whether revised tax policies (e.g., a stock transfer tax or a sliding-scale capital gains tax on stock transactions by otherwise tax exempt institutions) would contribute to a longer time horizon by corporate decisionmakers. There is a heated debate among economists regarding the effects of a securities transfer tax in general. One school views a transfer tax as a reasonable method to raise much needed revenue while discouraging unnecessary speculative trading. Another school believes a transfer tax would reduce market liquidity and potentially drive trading overseas. Congress should consider any such proposal carefully, because of its far reaching impact. If longer-term investment horizons could be encouraged and volatility could be reduced, without harming liquidity (or driving assets to foreign markets), this would be a positive f.

75. Enforcement

Over the past few years the SEC really seems to have stepped up its enforcement actions. The Dennis Levine, Boesky, Drexel and now the Millken cases have attracted great attention. I think the SEC's get tough attitude is viewed favorably here on Capitol Hill and across the country.

As Chairman of the SEC do you see a greater enforcement role in the years ahead? I venture to say that you should have the funding to pay for this enforcement. This year's budget, and the recent action by the Senate Appropriations Committee provides for an 18% increase in funding for the SEC.

An effective and aggressive enforcement program will continue to be essential to deter wrongdoers, preserve the integrity of the securities markets and thereby maintain the investor confidence that is vital for capital formation. The Commission must not tolerate, or appear to tolerate, fraud and criminality in our markets.

Because of significantly higher complaint levels, more complex cases and the international scope of this problem, I believe that the Commission's resources will still be stretched extremely thin, even assuming the very gratifying action of the Senate to appropriate the President's full request for the Commission is ultimately enacted by Congress as a whole. Until a more flexible funding program is enacted, the Commission's enforcement program may continue to be unable to respond as rapidly as would be desirable when major fraud cases are discovered.

76. Mr. Breeden, in the last five years corporate debt has increased by $840 billion. Corporate debt/equity ratios are at historic levels, and this is largely the result of the LBO/takeover phenomena.

The Campeau Acquisition of Federated stores last year resulted in $6 billion in new debt. The RJR Nabisco LBO resulted in a whopping $21 billion in leveraging.

A number of observers, including Alan Greenspan, have expressed great concern over this leveraging. They wonder what will

happen if we have a recession and companies have trouble servicing the debt.

Now I realize this is primarily a concern for the bank regulators, since it's the banks that carry these loans as assets. But what about the SEC's role here. The SEC has a general investor protection mission. And doesn't the SEC bear some responsibility for the types of transactions that are engendering the debt? If hostile takeovers were harder to accomplish, we might have a whole lot less leveraging in the economy. Does this argue for an increase in the SEC's market regulation function?

I believe that the Commission's market regulation functions should be significantly strengthened. For example, I believe that the Commission should have the authority to examine the financial condition of all financial affiliates of a broker-dealer -- including a parent holding company. The level of exposure of the consolidated firm's capital and liquidity resources, whether as a result of bridge loans or otherwise, should be a matter for oversight by the Commission. However, the specific mechanics of such oversight should be carefully structured to avoid unnecessary costs or inappropriate extension of regulation.

As you suggest, review of the exposure of lending institutions that are not affiliates of broker/dealers is largely a matter for bank regulators. The Commission's role, other than surveillance of exposure among securities firms, is to guarantee that the facts concerning each firm's leverage risks are fully disclosed to investors. The Commission is not equipped to substitute its judgment for that of the market as to purely economic issues -- such as whether a given level of return is consistent with the risk presented by a specific security.

77. When you look out at the Stock Market today it's hard to believe that one day almost two years that market dropped 508 points. This was a greater percentage drop than that of the famous crash in the late 1920s.

Now we're back at the levels of August 1987 -- the previous all time high has been surpassed. You kind of wonder where we are headed now.

I have a Wall Street Journal article from December 1987 analyzing the factors that caused the crash. The headline says

"Speculative fever ran high in the 10 months prior to black Monday", and inside there's an interview with Nicholas Brady, the head of the Presidential Commission investigating the Crash. He says: "'Incredibly' high prices caused market plunge."

Where are we now do you think Mr. Breeden? This article analyzing the occurrences of the summer of 1987 sounds an awful lot like today.

Market conditions today are significantly different than in October 1987. For example, the average stock price-earnings multiple at that time was almost double present levels. In addition, a variety of improvements have been made in our market systems since then. The "circuit breaker" procedures that are now in place should substantially improve the ability of securities and futures exchanges to address potentially destabilizing market volatility. Significantly greater capacity to process extraordinary trading volumes also has been installed in several exchanges since October 1987. I believe that the net impact of these and other changes has been to improve overall stability. However, more work can and should be done to improve domestic and international market stability.

78. Mr. Breeden, according to a 1986 report of the general accounting office, 89.9% of corporate equities are owned by 10% of all households. (This includes investment in mutual funds but not pensions. Pension funds now control about 25% of all equity. However, given that pension investments are determined by income, I'd venture to say that the bulk of pension assets benefit relatively few.)
So based on the GAO data I think you'd have to say that ownership of the means of production in this country is concentrated in very few people. And it's getting worse. The Leveraged buyout/corporate takeover trend has resulted in the retirement of $300 billion in corporate equity since the time of the GAO study -- so that means even fewer people own stock.

So if you're confirmed for this position Mr. Breeden you'll be presiding over an equities market that's increasingly becoming the province of the select few.

Now I happen to think that we'd be better off as a society and an economy if we had more capitalists, if there were more owners of corporate equity, more participants in our wealth creation system. What can we do to encourage more widespread ownership of equity? What about ESOPs?

Although I am not familiar with the 1986 GAO report, other data suggest that individual ownership of equity remains widespread. A 1985 survey conducted by the New York Stock Exchange revealed that 47 million individual investors in the U.S., or approximately one of every four Americans, owned stock in either a publicly traded company or in a stock mutual fund. These data indicate that equity ownership has become more broadly based over time; in both 1965 and 1975, a smaller percentage of Americans owned stock. Although large institutional investors account for a larger percentage of trading volume, many studies indicate that their share of equity ownership has not changed as dramatically.

In addition, employee participation in pension funds appears to be broad based. The 1989 Statistical Abstract indicates that in 1986, private and public pension funds held over $2,235.3 trillion dollars in assets. More than 50% of the civilian workers covered by those plans had incomes under $25,000.

I strongly agree that we should encourage greater savings and investment, and that we should encourage a broader participation in equity ownership. However, the extent of equity investment is a function of a number of macroeconomic factors, including, in the first instance, those factors influencing the rate of savings in the U.S. Public confidence in the integrity, fairness and stability of the securities markets is critical to encouraging public ownership of securities, since there are many other savings opportunities (such as bank deposits or direct real estate investments) that do not involve any type of security.

Active Commission oversight of disclosures of public companies, distribution and trading activities of market participants, and vigorous enforcement of the federal securities laws are aimed at fostering such public confidence. I believe the Commission, in its regulatory and enforcement activities as well as its rulemaking and legislative initiatives, should endeavor to foster a favorable climate for equity investing by all Americans.

79. Mr. Breeden, looking back at the two previous chairmen of the SEC, I'd have to say that John Shad was a man of great experience in the securities markets -- some would say perhaps too much experience in the securities

markets. On the other hand, David Ruder, Mr. Shad's successor, did not have market experience, but he was a professor of securities law. And I think some would say that Mr. Ruder may have been a little too professorial.

Now you are neither a legal scholar nor are you a market wiz -- but I'm not sure that's bad. Very briefly, can you give us what you think are your -- let's say -- three major qualifications for this job?

I believe that my personal integrity and commitment to public service, my professional training and experience, and my experience working with Executive Branch agencies and Congress will all serve me well in addressing the challenges that face the Commission. For a number of years I have worked with all of the federal financial regulatory programs, so I have a high degree of awareness of their structure and approach to many issues that cut across narrow market segments. I have also had intensive experience in reviewing the worst failure of financial regulation in American history. This experience taught me invaluable lessons regarding the operation of a supervisory program, the dynamics market incentives, the role of capital and sound accounting principles in maintaining stability and the dangers of widespread fraud and speculation. Working with Senior Administration personnel, members of Congress and market participants to design and enact a program to restore stability also gave me a vital perspective on dimensions of financial regulation.

In addition, please see Attachment A to my Senate Questionnaire for a longer statement concerning my specific experience and qualifications.

80. As you know, the SEC issued a policy statement in June that calls for the multiple trading of standardized options on exchange-listed securities and prohibits the restriction of these options to one exchange only. Despite repeated requests from my colleagues for studies evaluating the feasibility of a National Options Market Linkage System, the SEC has yet to provide a plan or study for market integration facilities. Are our markets ready to handle Multiple Options Trading? Are sufficient investor protections in place to ensure that the small, individual investor's orders are processed in a timely fashion? Has a

cost/benefit analysis been conducted which justifies this policy change?

I did not participate in any deliberation by the Commission prior to its unanimous action to adopt the new multiple options trading rule. I am not aware whether a detailed cost/benefit analysis was performed by the Commission. However, I have been informed that when the Commission approached multiple trading of options, it carefully weighed the reasonably anticipated benefits against the possible adverse consequences of an expansion of multiple trading -- namely, market fragmentation and domination by one market. Both the Commission and the staff apparently determined that, on balance, the benefits to be derived from multiple trading would outweigh any reasonably anticipated costs, and the problems, if any, that would result from full scale multiple trading would be small and manageable.

Rather than restricting options from multiple trading, and thereby removing the substantial benefits that such competition provides, the Commission determined that the exchanges should work on reducing any perceived market fragmentation problems. Rule 19c-5 will not take effect until January, and there will be a one-year phase-in period thereafter. During this time, the Commission should closely monitor any exchange efforts to implement cost-effective market integration systems.

In the companion White Paper to the approval order for Rule 19c-5, the Commission discussed the various means of implementing market integration facilities and discussed the advantages and disadvantages of each approach. Moreover, since issuance of the White Paper, the New York, Pacific, and Philadelphia Stock Exchanges have commenced a study of the methods for developing options market integration facilities, as has the American Stock Exchange in conjunction with the Chicago Board Options Exchange.

81. Mr. Breeden, legislation on corporate takeovers has vexed this Committee for some time. I for one believe that there are a number of needed reforms in this area that should be made.

Indeed, I have a copy of a draft takeover reform bill that's presently in circulation (by Congressman Markey Chairman of the House Telecommunications and Finance Subcommittee). I'd like to ask what you think about a number of the reforms included.

First, closing the 13(d) window -- the so-called 10 day window. I presume you support that?

Second, what about a requirement that firm financing be in place before a takeover is commenced? This would get at the problem of the "Highly Confident Letter" that can be bought for a very small fee and contributed to the relative ease with which takeovers can be launched.

Third, a so-called "Community Impact Statement?" Should we let communities and employers know what a raider may have in store for their economic mainstay. Many employees and residents of affected communities are shareholders. Do they have a right to know if the company would be "Busted Up?"

Lastly, what about something not included in this bill -- but was included in last year's senate takeover bill. What do you think of giving extra time for an employee stock ownership plan to buy a company when a takeover is threatened?

I support appropriate action to "close the 10-day window," such as the Commission's proposal to set a five business day reporting period, coupled with a standstill requirement as to further purchases until a filing is made. Such a standstill provision protects against any further accumulation of securities until the market is informed of the triggering acquisition. However, the Commission has also taken the position that anything less than five business days would impose significant compliance costs and logistical problems for some acquiring persons.

The Commission has traditionally opposed legislation requiring that firm financing be in place before a takeover is commenced. In general, bids that are not credible, in which the bidder is not seen as able or willing to fund the bid, will have little effect in the marketplace. Item 4 of Schedule 14D-1, the principal tender offer document, mandates disclosure of the source and total amount of funds and other consideration to be used if the bidder were to purchase the maximum number of shares in a tender offer.

Although Item 4 does not require that a bidder finalize financing before commencing a tender offer, once a significant portion of the financing is arranged, the bidder must amend its tender offer documents to disclose that fact. In addition, shareholders must have at least 5 business days, depending on the materiality of the information, to consider this new information. The change of financing status from uncommitted to legally

committed, or "firm," is a material change that triggers an additional "waiting period" for information dissemination.

The Commission has traditionally objected to a community impact statement requirement for several reasons, including the fact that the Commission has not felt that such information is directly relevant to an investor's decision. I share the Commission's view that such a requirement would not assist shareholders in making an informed investment decision. Such a requirement might also result in lengthy litigation as to the adequacy of the statement in every hostile bid. The result would be to tilt the careful neutrality of federal law toward protecting incumbent management.

Limitations on the Commission's jurisdiction necessarily confine its interest in ESOPs to disclosure-related issues. The Department of Labor's Pension and Welfare Benefits Administration regulates the investment and fiduciary aspects of employee benefit plan participation in such transactions, while the Internal Revenue Service administers applicable tax provisions. Under ERISA, the use of an employee benefit plan, either offensively or defensively in connection with a takeover, may be illegal if deemed inconsistent with the best interests of the plan. ERISA provides that failure by the plan sponsor and other fiduciaries to establish and to operate a plan prudently and in the sole interest of employee participants will result in ERISA liability.

In considering any changes affecting ESOPs, Congress should take into account that its original purpose for ESOPs was to enhance employee ownership of U.S. corporations. This purpose does not appear to be served by favoring the use of ESOPs as a defensive takeover device.

VI. Questions from Senator Terry Sanford

82. Mr. Breeden, one of the aspects of corporate takeovers that is most troubling to me is the financing for such deals. Indeed, I am convinced that one of the reasons that we have seen such a tremendous rise in the number and dollar value of hostile transactions is the development of new, creative financing techniques that allow bidders to put companies in play with virtually no money down and none of their own funds at risk.

During your work on the savings & loan bill, you worked hard to stress the importance of firms having their own capital at risk. I wonder how you feel about greater requirements in takeovers and leveraged buyouts for the bidders to have to put up real money -- not highly confident letters or other loose arrangements or bridge loans. Indeed, I was reminded upon reading the story in today's Wall Street Journal about the bid by Campeau for Allied Stores. When the deal was financed, First Boston committed $1.8 billion at a time when First Boston's holding company balance sheet had $1.1 billion in equity. By using its parent company and not its broker-dealer affiliate, First Boston avoided the broker-dealer net capital rules.

Some have suggested that we require that bidders demonstrate firm financing commitments. I have proposed that bidders be prohibited from financing more than 50% of their acquisition through pledging of assets of what they are trying to takeover. There are doubtless other ways, through margin requirements and other mechanisms to get at this problem of loose financing of these deals.

What specific steps do you think the SEC could or should take to address the problem?

I share your concerns over the potential exposures for unsafe lending practices, especially with large financing commitments by the holding company or other affiliates of a broker-dealer, which are not now subject to oversight by the

Commission. Such commitments can be of a magnitude that could expose the broker-dealer to substantial liquidity risk and raise systemic concerns for the larger securities system. Additional Commission authority to address bridge financing exposures may be appropriate.

The Commission has not supported a requirement that tender offers be financed prior to commencement. The Commission's rules for such transactions require disclosure of the source of financing, including the absence of such arrangements, and require the disclosure of any plans to obtain the financing. On the basis of that disclosure, the market evaluates the nature and extent of the bidder's financing in assessing the probability that an announced takeover attempt will be consummated.

When an offer is commenced without financing in place, and financing is later obtained, that fact will constitute a material change in the information previously provided to shareholders. The bidder will be obligated to amend its tender offer materials, disseminate the information to shareholders, and extend the offering period, if necessary to provide shareholders with adequate time to consider the information.

83. A related concern to corporate takeovers and leveraged buyouts that have been troubling me for some time is the increasing short-term focus of management and the resulting cutback in research and development and other activities that would lead to long-term competitiveness. In an article last year, Professor Peter Drucker observed that "the fear of the raider is undoubtedly the largest single cause for the increasing tendency of American companies to manage for the short-term and let the future go hang."

While every manager agrees that one of the best defenses of a corporate raid is a high stock price, the company investing in a long-term strategy is likely to suffer a short term decrease in its stock price, thereby opening itself up to an unwanted raid. A Partner at Goldman, Sachs once noted "I don't think any company can afford a long-term investment unless its managers own 51 percent of it." In a recent hearing before this Committee on the Defense Production Act, Norm Augustine, the Chairman of Martin-Marietta remarked on the experience of his company following the announcement of a major research and development effort -- the institutional investors immediately dumped

their shares of the company, resulting in a major drop in stock price.

What specific steps do you think the SEC could or should take to address this problem.

The Commission should encourage policies that will foster long-term savings and investment. All of the Commission's programs, and especially the Enforcement program, should reinforce the safety and integrity of the market so that investors will have the confidence to follow long-term investment strategies.

84. Most of the debate on corporate takeovers and leveraged buyouts has focused on the effect these transactions have on stockholders. Indeed, the main thrust of the Williams Act is to give shareholders sufficient time and information to evaluate takeover bids. The theory seems to be that if the stock price is up, all is right with the world.

I am afraid that is too narrow an approach, as a corporation is much more than its stock price. While stockholders' interest certainly deserve protection, others, including creditors, employees, pensioners and the corporate community deserve some consideration as well.

One of the major constituencies that has clearly suffered through this wave of takeovers are the bondholders of our corporations. In the recent buyout of RJR Nabisco,, RJR bonds lost 20% of their value nearly overnight. As early as 1985, Business Week observed that "the takeover and leveraged buyout craze may be a boon for shareholders, but it is slaughtering owners of high-grade corporation bonds."

Do you think that, as a matter of public policy, it is appropriate to permit deals to be done that basically take from the bondholders to give to the shareholders? Should the SEC do anything about it?

Under long established corporate governance principles, a corporation's directors owe fiduciary duties, including duties of care and loyalty, to the company and its equity shareholders. While the scope of the duties owed to bondholders has recently been questioned, the law to date has been fairly clear that a

fiduciary relationship does not exist under state corporate law between a bondholder and the company and its directors. A bondholder's rights are largely a matter of contract. The contract or indenture underlying the bond establishes the rights and responsibilities of the two contracting parties at the time the securities are purchased, and bondholders are legally entitled to all the rights set forth in such indenture.

The Division of Corporation Finance's staff is reviewing and evaluating disclosure in the offering materials distributed to prospective bondholders. If necessary, the staff will propose changes in the appropriate rules and schedules to ensure improved disclosure of the risks of going-private or other leveraged transactions.

In addition, the market may respond to the risk of a significant change in the capital structure of an issuer by requiring more protective covenants for bondholders. Generally, such provisions allow the bondholder to exercise an option to sell the debt instrument back to the issuer upon the occurrence of a certain specified event, such as a change of control resulting in a downrating of the issuer's bond rating. Full disclosure of the types of covenants that protect bondholders should be required by the Commission. Generally, however, the scope of duties of directors to the corporation, shareholders and others is a question determined by state rather than federal law.

85. I would like to ask you for your opinion on various possible changes to our securities laws that would effect corporate takeovers and leveraged buyouts. I am looking for your opinion, not that of the SEC.

a. Closing the 13(d) window -- Virtually every witness to appear before this Committee has agreed that the 13(d) window should be closed. Do you agree and how would you close it?

Yes, I would support a change to require the filing of a 13D within 5 business days, and to provide for a stand-still in purchases until the filing was made. The standstill provision protects against further accumulation of securities until the market is informed of the triggering acquisitions.

86. Lower the 13(d) 5% threshold -- Last year, a bill that many on this Committee supported was introduced with a provision to lower the 5% threshold to 3%. Would you support that provision?

No. The purpose of the Schedule 13D filing is to disclose holdings that may have control implications. The Commission historically has concluded that the 5% threshold is sufficient to serve this purpose. The 5% threshold is a benchmark commonly used in other statutes, such as the Bank Holding Company Act, as a point below which control is conclusively deemed not to exist. Reducing the level would be inconsistent with such other statutes, as well as creating costs that the Commission has believed would be significantly in excess of any benefits to be gained.

87. Extend the tender offer time period -- Many believe that shareholders and management do not have sufficient time to respond to offers or to arrange counter offers. Would you favor an extension of the tender offer time period? From 20 days to what? 45 days? 60 days?

The rules and regulations governing tender offers are designed to assure that security holders have adequate time to make an informed investment decision. The Commission has consistently taken the position that the current time periods required by the rules under the Williams Act provide adequate time for investors to make an informed decision, i.e., the 20 business day minimum offer period, the minimum of 10 business days following changes in the number of shares being sought or the price, and the 5 to 10 business days (depending on the nature of the change) for other material changes.

Given the pervasive use of poison pills, and the extent of various other devices that give management additional time (usually significantly in excess of 20 business days) to review alternative transactions, the minimum offering period of the Williams Act has become largely academic. Therefore, I do not believe any time extension is necessary at this time.

88. Many others feel that a more accurate description of what constitutes a "group" should be included to preclude individual members of groups from each buying 4.9% without crossing the 13(d) threshold. Do you think a statutory change should be made to tighten the definition along the lines outlined in S.1323, as reported out of this Committee last year?

The definition of a "group" should certainly embrace individuals who each acquire a 4.9% interest under an express or implicit agreement in order to avoid crossing the 13(d) threshold. Existing Commission rules, appropriately enforced,

are sufficiently broad to address arrangements or understandings that are not written or express. Under existing law, parallel conduct can be evidence of the existence of a group, and I strongly support the use of such evidence in Commission enforcement proceedings in all cases where the facts warrant.

At this time I do not believe legislation is needed to detect and penalize the type of abuse you describe. However, if confirmed I will be alert to developments that suggest a need for legislation.

89. Many others feel that two-tiered offers are particularly manipulative. To combat this, an "all or none" requirement could be added to require all shareholders with more than 25% of a company to purchase any additional shares through a tender offer for all of the outstanding shares. Would you favor such an approach? If not, what steps, if any, do you think are appropriate to combat two-tiered or creeping offers?

Judicial response to two-tier offers, market forces and so-called "fair price" charter amendments and state statutes appear to have corrected any perceived problems that may have existed. Indeed, because of these developments it is more common that two-tier offers would be undertaken by the target or friendly bidder, as in the case of the Time bid for Warner in response to a hostile third party bid.

As a practical matter, hostile two-tier offers have greatly decreased in frequency. As a result, additional legislative restrictions do not appear necessary at this time.

90. In the bill reported out last year, S.1323, the Committee adopted a provision for the recovery of greenmail profits. Do you favor this approach? If not, what should be done about greenmail?

The regulation of the use of corporate assets to repurchase an issuer's shares is traditionally subject to state law. If a board of directors fails to fulfill its fiduciary obligations, appropriate remedies are available under state doctrines of corporate waste and breach of fiduciary duties. An appropriate federal response to greenmail would be the use of the disclosure mechanisms to alert remaining shareholders to a substantial securities repurchase. Because this issue was being addressed by court cases and charter amendments, the Commission in 1986 and 1987 decided not to support federal proposals limiting greenmail. I concur with Commission's determination.

91. Do you favor any changes in the proxy process and if so, what changes?

I am aware that a number of institutional investors have raised questions about the proxy process, and that the staff of the Division of Corporation Finance is reviewing these matters. If confirmed, I shall give careful consideration to the concerns that have been identified and to the staff's proposed responses.

92. Numerous examples have been brought to our attention where managements have taken companies private in a leveraged buyout and then relatively shortly afterwards taken the companies public again at astronomical profits. What is your response to charges that there is an obvious conflict of interest in these leveraged buyouts?

I agree that there are potential conflicts of interest and informational advantages in management buyouts. These factors have long been recognized and addressed by the Commission and the courts. The duties of a corporation's directors, including the duties of care and loyalty to the company and its equity shareholders, are well established under state law. Where a transaction involves the potential for self-dealing, courts have required directors to demonstrate good faith and the inherent fairness of the bargain. As a practical matter, the inherent informational advantage of management cannot be eliminated. However, procedures can be designed to isolate interested directors from the consideration of the transaction, and to enhance the level of disclosure.

While evaluation of the substantive fairness of transactions has developed under state law, the federal securities laws have focused on the disclosure needed by security holders to assess the fairness of the transaction. Disclosure of management's interest in a transaction and a description of the procedures followed to evaluate a transaction permit security holders to evaluate whether interested directors have effectively neutralized conflicts of interest. In addition, Rule 13e-3 is intended to elicit material information regarding the transaction, including the board's deliberative process in assessing the transaction, so that security holders independently can evaluate the fairness of the transaction and pursue legal remedies available under state law.

93. What is your response to the allegation that "anybody can buy a fairness opinion?"

Legitimate concerns have been raised as to the reliability of fairness opinions. Indeed, Rule 13e-3 currently addresses these concerns through disclosure of the compensation to the

advisor and any existing relationships with the parties. Disclosure also is required of the procedures and methodologies employed by the financial advisor. In addition, the adequacy of the procedures used by the financial advisor in rendering its opinion may bear on the degree to which directors will be credited with reasonable care under state law in determining whether they satisfied their fiduciary duties.

State law standards of care may be violated if the board of directors places unreasonable reliance on a fairness opinion in evaluating the fairness of the consideration offered in a transaction. In this regard it is worth noting that there is ongoing state court litigation concerning allegations of malpractice in connection with the preparation of fairness opinions in certain transactions.

94. What should be the role of the Commission in ensuring that shareholders are treated fairly in these leveraged buyouts?

Because of the informational advantages of management, and the inherent conflicts of interest that arise when management is on both sides of a transaction, the Commission should actively promulgate and enforce disclosure rules, such as Rule 13e-3, designed to provide shareholders with the information necessary to make an independent assessment of the fairness of the transaction. The Commission should review its rules in light of market developments to ensure that shareholders receive adequate information to make that determination.

95. What reforms to Rule 13(e)(3) would you favor?

The Division of Corporation Finance is preparing a rulemaking proposal for Commission consideration that would amend the transactional disclosure requirements to enhance shareholder analysis of extraordinary corporate control transactions recommended or approved by the board of directors. The proposals also would amend Rule 13e-3 to ensure that its disclosure requirements reach all going private transactions in which management has a significant interest. I generally agree with the goals of these proposals.

96. Would you support a requirement prohibiting fairness opinion authors from having a financial stake in the outcome of a transaction?

Federal law does not mandate that a fairness opinion be obtained, and it does not impose restrictions on the independence of persons providing such an opinion. As noted, Rule 13e-3 requires disclosure of the compensation of the advisor and any

existing relationships with the parties. Disclosure of any conflicts of interest are intended to help shareholders avoid placing undue reliance on an opinion by a financial advisor with a financial stake in the transaction.

97. Would you favor disclosure of all studies and analyses and projections prepared by or for management in preparation for a management buyout?

Since reports, opinions and appraisals from an outside party materially relating to a transaction are presently required to be disclosed, I would support extending this requirement to include similar disclosure by management of its internal reports, opinions and appraisals that are materially related to the transaction.

98. Would you favor extending the time period following the announcement of an LBO and the time of the consummation of the deal? If so, to how many days.

No, my current view is that existing statutory waiting periods are sufficient. Current transactions generally last much longer than the minimum federal requirements. I would of course remain open to reviewing the adequacy of time periods if current conditions change.

99. In defending his restraint on Commission resources, former SEC Chairman Shad argued that the SEC is not the sole defense in enforcing full disclosure. He contended that false or misleading disclosures will be subject to attack by the private bar in the form of class action suits. What is your view on the Commission shifting some of the burden to the private investors? Should we provide greater rights for private action under Section 13 of the Securities Exchange Act?

For at least 25 years, the Supreme Court has permitted private rights of action under the federal securities laws as a "necessary supplement" to Commission enforcement actions. Persons who have been injured by securities law violations often will have the incentive to seek recovery for the violation. Such suits serve both a remedial purpose, and act as a powerful deterrent to violators.

Private actions do not, however, serve all of the ends served by Commission actions. The Commission may be able to sue where no private litigant can or will, and the Commission often

can obtain relief in the public interest that is not generally available to a private litigant. Therefore, private actions supplement the Commission's enforcement program, but they cannot substitute for a vigorous and well-staffed Commission enforcement program. I do not believe that legislation to provide greater private rights of action under Section 13 of the Exchange Act is needed at the present time.

100. The surge in instances of fraudulent securities activities by persons associated with savings and loans and other financial institutions raises serious questions. An enhanced governmental enforcement presence is clearly warranted. Does the SEC intend to step up its activities in this area? How will the SEC coordinate with interested bank regulatory agencies to address this serious issue?

The Commission has a long history of taking effective enforcement action against financial institutions and persons associated with such institutions for violations of the federal securities laws. For example, the Commission's enforcement activities were instrumental in bringing to light fraudulent accounting practices being utilized at Financial Corporation of America, then the nation's largest savings and loan holding company. The Commission's enforcement efforts directed at financial institutions and persons associated with financial institutions will continue and should be expanded as needed.

The Commission does not have primary jurisdiction over the securities of banks and savings and loan associations that are not subsidiaries of a holding company. Section 3(a)(2) of the Securities Act exempts from the Act's registration requirements "any security issued or guaranteed by any bank," and Section 3(a)(5) exempts securities "issued by a savings and loan association." In addition, under Section 12(i) of the Exchange Act, each bank regulatory agency administers the periodic reporting and proxy provisions of the Exchange Act for banks and savings and loan associations under its jurisdiction.

In my opinion, these exemptions may place bank regulators in a conflict of interest in applying the securities laws, and they weaken the protection of investors and the ability of the Commission to police fraud by these depository institutions. These provisions are also inconsistent with the Commission's authority to administer the Securities Act and the Exchange Act for the securities of publicly-held bank and thrift holding companies. While cooperation will always be important, repeal of the bank and thrift exemptions described above would provide more effective enforcement at lower cost to the public.

101. A number of witnesses have appeared before this Committee to stress the paramount importance of maintaining the integrity and fairness of the securities markets. They point to the rising apprehension of the individual investor faced with massive securities trading scandals, increasingly complex securities products, and alarming short-term volatility. What is your response to the arguments that the individual investor is not getting a fair shake in today's marketplace?

However, because of the large number of competitive alternatives, the securities industry must convince investors of the fairness and desirability of investing in the securities markets. Through an active enforcement program, the Commission can help to create a favorable climate for investors by helping to maintain the fairness and integrity of the market and preventing abusive practices.

Individual investors in securities continue to play an important role in the nation's markets, increasingly through collective investments in securities such as pension plans and mutual funds. Indeed, over the long term, individual investors who purchase and hold specific stocks due to their investment fundamentals have historically realized significant long-term appreciation. However, because of the large number of competitive alternatives, the securities industry must be able to convince investors of the fairness and desirability of investing in the securities markets. Through an active enforcement program, the Commission can help create a favorable climate for investors by helping to maintain the integrity of the market.

102. As you know, a number of members of Congress are concerned about the implications of the bid by Hoylake Investments Limited -- a Bermuda corporation controlled by Sir James Goldsmith and his partners -- for B.A.T. Industries. B.A.T. has a major subsidiary in the U.S., BATUS, which owns a number of America's most prominent businesses -- Marshall Field's, Saks, Brown & Williamson, Hardees Foods, Iveys, the Farmers Insurance Group and others.

The offer by Hoylake is a highly leveraged offer which would leave U.S. investors in B.A.T. with unidentified securities in a "squeeze out transaction." The bid is to be financed through the issuance in the U.K. of junk bonds that will inevitably come to rest

in the United States, given the lack of a junk bond market in the U.K.

As you know the SEC has declined to assert jurisdiction over this transaction.

Do you believe the SEC should assert jurisdiction over this type of bid?

Should our laws be amended to ensure that the SEC will apply our securities laws where a tender offer for a foreign private issuer has the requisite "substantial effects" in the U.S. to support the jurisdiction of our securities laws?

Should our securities laws apply to dollar-denominated junk bonds issued abroad when the issuer knows they will inevitably come to rest in the U.S.?

The Commission can only act where it has jurisdiction under the law. As noted above, the staff of the Commission, after a thorough review of all pertinent issues, determined that the Commission does not have the basis for asserting jurisdiction.

Foreign issuers making an exchange offer of this kind frequently do not extend offers to U.S. holders because they are unwilling to bear the costs and other burdens of registering securities in the United States. The U.S. securities laws and the principles of international comity would not permit the Commission to force a foreign issuer to enter the U.S. securities markets against its will, even though U.S. investors may be excluded from investment opportunities.

Because of the negative impact of this situation on U.S. securityholders, I would support efforts to reduce U.S. regulatory disincentives to extending offers to U.S. holders on equal terms with those of other shareholders, where the home country's regulatory scheme is adequate to protect investors and the percentage of shares held by U.S. persons is not significant. However, in any such system jurisdiction over fraudulent conduct that has an effect on U.S. persons should be retained. The multijurisdictional disclosure system, currently proposed for comment with respect to rights offerings and cash and exchange tender offers involving Canadian companies, may be a useful model for further reform.

An unregistered distribution of securities in the U.S. is unlawful, even if the offer uses the device of an overseas distribution unless there is adequate assurance that such securities would "come to rest" outside the U.S. Therefore, the Commission must review the specific facts of any such transaction to determine whether there has been a violation of U.S. law.

VII. Questions from Senator Richard C. Shelby

103. Leveraged buyouts and hostile takeovers are the focus of national concern. These transactions may be burdening many American corporations with a dangerous level of debt, which will restrict their ability to modernize, withstand economic downturns, and meet challenges from both domestic and overseas competitors. I am concerned that some of these hostile takeovers and leveraged buyouts may not comply with the law. It is my understanding that most federal courts are presently denying standing to private parties who attempt to raise the issue of whether or not a particular tender offer violates the margin requirements set out by the Federal Reserve Board. This means that the initiation of a enforcement action by the SEC is the only practical way to obtain such a court determination. Are you familiar with what internal standards and criteria are applied by the SEC in deciding whether or not it is appropriate to file such an enforcement action?

It is my understanding that the Federal Reserve Board sets the margin requirements and that the SEC is charged with enforcement. In a situation with which I am familiar, the recent takeover of West-Point Pepperell by Farley Industries, the Federal Reserve took the position that a private party should be permitted to enforce margin regulations. In a memo from Gary Lynch to Chairman Ruder of December 20, 1988, Mr. Lynch states his understanding "that the Board's limited staff resources make it difficult for the Board or its staff to become involved in a detailed factual analysis of every potential margin violation." This situation gives arise to two concerns. First, the Board's suggestion that a private right of action for West-Point Pepperell shareholders is desirable implies that the Board suspects that margin requirements may have been violated. Yet the SEC took no enforcement action. What is the nature of the communication between the Board and the SEC on the issue of margin requirement violations? Does the SEC not

have the authority to act when it suspects that margin requirements have been violated? Is it necessary for the Board to explicitly request enforcement action? Second, Mr. Lynch's comment concerning the limited resources of the Board is also true for the SEC. Are staffing and resource shortages responsible for the SEC's failure to act? If the SEC receives its current funding request, is it likely that enforcement of margin requirements will receive a higher priority?

In light of the limited resources of the SEC and the Board, and the magnitude of other responsibilities, would it be beneficial to provide for a private right of action for the enforcement of margin requirements?

I am not familiar with the specific criteria used by the Commission in deciding whether to file an enforcement action for a violation of margin rules. I am also not aware of the nature or sequence of communications between the Commission and the Federal Reserve Board (the "FRB") concerning enforcement of the margin rules in the West-Point Pepperell case.

The Commission will not hesitate to enforce the margin rules where there are violations. Indeed, several counts in the Drexel complaint were based on margin violations, and the Commission recently commenced an action against Toronto Dominion Bank and others based, in part, on margin violations. The Commission does not require an explicit request from the FRB for the Commission to commence an enforcement action. However, the Commission's staff would normally seek the FRB's views on any interpretive question that might arise under the margin rules, and it is unlikely that the Commission would proceed with any enforcement action if the FRB took the position that a violation had not taken place.

104. In light of the limited resources of the SEC and the Board, and the magnitude of other responsibilities, would it be beneficial to provide for a private right of action for the enforcement of margin requirements?

Section 7 of the Exchange Act does not provide an express private right of action. While the Commission once supported an implied private right of action for borrowers, most courts have held that a borrower lacks standing to sue its lender for a violation of the margin rules.

The case law regarding whether there is an implied right of action for a tender offer target under Section 7 is unsettled,

and the Commission has never specifically endorsed an implied private right of action for actions brought by tender offer targets under Section 7. Before endorsing this remedy, I would want to compare the benefits from private actions against the costs. In particular, I would want the Commission's staff to analyze the impact of widespread private litigation, which would create greater dangers of inconsistent interpretation of the margin requirements.

105. The Business Roundtable has challenged the SEC's "one-share/one vote" rule in the U.S. Court of Appeals. If the court overturns the SEC's action, what action would the SEC take on this issue?

There is not any reason to suppose that the Court of Appeals will not sustain the Commission's authority to issue the rule in question. However, in the event of an adverse result, the Commission will have to consider additional steps, including presenting this issue to Congress.

106. The twenty business day minimum offering period required by current SEC tender offer regulations often has proven inadequate to give most shareholders a full opportunity to receive, digest, and act on tender offer disclosures. Would it be preferable to increase the tender offer period to thirty-five business days? If a qualified employee stock ownership plan (ESOP) holds stock subject to the tender offer and announces an intention to make a substantially equivalent bid, the tender offer period could be extended, for as long as 95 business days. An ESOP would not qualify unless the plan owned at least 10 percent of the voting securities of the company for at least six months when the competing tender offer commenced. In your opinion, is it appropriate to provide an extended tender offer period for ESOPs or will this increase management abuses of ESOPs?

The regulations governing tender offers are designed to assure that shareholders have adequate time to make an informed investment decision. The Commission previously has stated that the minimum 20 business day period coupled with the additional requirement that an offer remain open for 10 business days following changes in the number of shares being sought or the price, and other extensions for material changes, provide adequate time for investors to make an informed decision. Additional delays do not appear necessary.

Limitations on the Commission's jurisdiction necessarily confine its interest in ESOPs to disclosure-related issues. The Department of Labor's Pension and Welfare Benefits Administration regulates the investment and fiduciary aspects of employee benefit plan participation in such transactions, while the Internal Revenue Service administers applicable tax provisions. Under ERISA, the use of an employee benefit plan, either offensively or defensively in connection with a takeover, may be illegal if deemed inconsistent with the best interests of the plan. ERISA provides that failure by the plan sponsor and other fiduciaries to establish and to operate a plan prudently and in the sole interest of employee participants will result in ERISA liability.

In considering any changes affecting ESOPs, Congress should take into account that its original purpose for ESOPs was to enhance employee ownership of U.S. corporations. This purpose does not appear to be served by favoring the use of ESOPs as a defensive takeover device. Moreover, Congress may wish to consider the extent to which ESOPs constitute a further subsidy for debt over equity financing, because of the special interest deductions provided for ESOP-related debt.

107. The repurchase of shares of stock by the issuing corporation from a shareholder at an excessive premium or greenmail is an abuse of corporate assets. Would you support limiting the payment of greenmail by giving a company the right to recover any profit by a person who sells the company its own stock, if that person held more than 3% of the stock and has held it for less than a year? Further, do you support permitting shareholders to sue derivatively to recover "greenmail" profits on behalf of the company if the company either fails to bring action within 60 days after the shareholder request or fails diligently to prosecute any such action?

Although the Commission proposed limitations on greenmail payments in 1984, it has since twice revisited that issue, in 1986 and 1987, and determined that the matter should be left to state law. If a board of directors fails to fulfill its fiduciary obligations, appropriate remedies are available under state doctrines of corporate waste and breach of fiduciary duties. An appropriate federal response to greenmail would be the use of disclosure mechanisms to alert remaining shareholders to a substantial securities repurchase and to the possibility of state law remedies. In addition, federal tax liabilities have been created that apply to certain greenmail payments, and in some state-law cases greenmail has been found to be unlawful.

108. "Golden parachutes" or payments in excess of three times annual compensation as defined by the Internal Revenue Service, would be prohibited in my legislation, unless affirmed by a majority of the outstanding voting securities of the company. Do you support this protection of shareholders?

In recent years, the Commission has deferred to state law with respect to golden parachutes, as a matter involving the duties of officers and directors and the internal affairs of the corporation. However, I am not unsympathetic to the desirability of reconsidering the necessity for a shareholder vote to approve any such plan that might reasonably be expected to have a material impact on the value of a corporation's shares.

109. "Poison pills" or issues of securities designed by corporate management to discourage a hostile merger could be limited by prohibiting such issues unless approved by a majority of shareholders or exempted by the SEC. Do you support limiting poison pills?

The Commission has devoted substantial attention to poison pills. It filed an amicus brief in the Delaware Supreme Court expressing concern with the effect that such plans may have on proxy contests and tender offers. It also issued a concept release to elicit public comment on what, if any, response should be taken by the federal government to the proliferation of such plans. The Commission subsequently determined not to support legislative curbs on poison pills because they involved matters of corporate governance traditionally subject to state oversight.

However, while the Commission in the past has determined not to respond to defensive measures adopted by management such as poison pills, I am not unsympathetic to the desirability of reconsidering the necessity for a shareholder vote to approve any poison pill or similar charter amendments that might reasonably be expected to have a material impact on the value of a corporation's shares.

110. The proxy voting process is currently subject to manipulation by corporate management with strong vested interests in the outcome of controversial issues put to a shareholder vote. I believe that pressure from corporate management on pension fund managers, institutional investors, and individual shareholders could be limited by providing for confidentiality in the proxy voting process. My legislation would require the

SEC to promulgate regulations that require confidentiality in the granting and voting of proxies and that would provide for vote tabulation by an independent third party. Please comment.

The Commission, in reviewing disclosure made in proxy materials and otherwise administering the proxy rules, is engaged in an ongoing examination of these rules. In the past, the Commission also has urged careful study of proposals to change the proxy system prior to any legislative actions mandating such changes. This has included such proposals as mandating confidential voting and independent tabulation of votes as well as granting significant shareholders greater access to the corporation's proxy statement. Particularly in the case of fiduciaries voting securities on behalf of others, absolute confidentiality and the resulting lack of oversight may increase the risk that fiduciaries will vote the securities contrary to the interests of the beneficiaries. On the other hand, confidential voting may serve to eliminate any real or perceived coercion by corporate management on the voting decisions of employees. This is particularly significant at a time when, as a result of the proliferation of ESOPs, employees are gaining a greater say in corporate governance.

VIII. Questions from Senator Robert Graham

111. The '34 Act mandates that insiders are required to file (with the SEC) evidence of their transactions in their own companies stocks. This information is currently disseminated by much of the news media, including the Wall Street Journal and USA Today. Investors and investment advisors also gain access to this information via on-line computer services such as Dow Jones News Retrieval. A proposal is under consideration that would alter the filing requirement so that many of those officers who presently file will no longer have to do so. Since many middle management employees, that would be in a financial position to invest in their own company's shares, would have in their possession by nature of their duties, information not available to the general investing public, or even top management (i.e. faulty design problems, product development problems, slumping divisional sales), why does the public interest require doing away with this reporting requirement?

The proposed rules were not intended by the Commission to eliminate this requirement, but rather to modify the definitions now used in order to make the current disclosure more focused and meaningful. Under the Commission's proposal, the definition of "executive officer" now used in the Commission's proxy rules (i.e., president, any vice president in charge of a principal business unit or function, or any other person who performs a policy-making function for the company, and any officer of a subsidiary who performs a policy-making function for the issuer) would be used for this purpose. Principal financial officers, controllers or principal accounting officers and officers of a parent company who perform policy-making functions for the issuer also would be added.

Consistent with the statutory purpose and recent case law, an officer's title alone would not be determinative. Instead, an officer's executive or policy-making duties would govern. The Commission anticipates that there may be a reduction in the number of officers filing Section 16 reports with respect to companies that currently use a broader interpretation of the term and include all titled vice-presidents, regardless of duties. However, many companies already use the proposed definition for determining who is an officer for purposes of Section 16.

The designation as an officer for purposes of Section 16 has effects beyond reporting obligations. An officer also is subject to the short sale prohibition and to short-swing profit recovery for purchases and sales within a six month period, even if the officer was not in possession of inside information. Thus, it is important that the definition of officer be clear and limited to one that will achieve the statutory purpose. To the extent that persons outside the proposed definition come into possession of inside information and conduct transactions based on this information, they will be subject to the insider trading prohibitions of Sections 10(b), 14(e), and 21A of the Exchange Act.

In reviewing the public comments concerning this proposal, the purposes and benefits of these filings will be a very important factor. If confirmed, I will inquire very carefully as to the justification for any reduction in the scope of the current filing requirement.

112. This same proposal permits changes in filing requirements for corporate insiders with regard to the reporting of their employee stock options so that an insider will be able to defer reporting the fact that he has exercised options for up to a year after the event. Currently however, this information has been made available by the tenth day of the month following the event. Experts agree that investors, financial advisors, and stock analysts routinely use this information to make buy, sell, and hold decisions.

Since critics argue that it is the exercise of options, not the granting of them, that signals that an insider has made a "buy" decision, if this proposal is adopted, it will be possible for insiders to accumulate stock unnoticed for up to a year until they report those exercises on an annual filing.

As the practice of exercising options is the primary form of accumulation by insiders in large capitalization companies, critics also argue that insiders, seeking to avoid publicity of their trades, will alter their company option policies so that option buying will virtually replace conventional open market buying, creating a "loophole" in the system.

Since a year time lag for this type of reporting represents an eternity for today's

markets where hundreds of millions of shares are traded daily, please explain why it is in the public interest to delay this reporting for as much as a year.

The Commission's original proposal has now been significantly revised, and the revised proposal is now subject to public comments. If confirmed, I will carefully review the comments concerning this important issue.

113. Have you undertaken a detailed cost/benefit analysis that demonstrates convincingly that any burdens of reporting are not outweighed by investors' need to know this important information so as to make fully informed investment decisions?

No, I have not undertaken any cost benefit analysis of this proposed rule. However, I would note that the Commission's proposing release summarized the costs and benefits of this proposal as perceived by the Commission.

IX. Questions from Senator Timothy E. Wirth

114. Bank Powers and Glass-Steagall

> One of the most important policy debates in recent years has focused on the powers and regulatory treatment of commercial and investment banks. You have made thoughtful and important contributions to this debate and, in the past, you had advocated bringing down the Glass-Steagall separations between commercial and investment banking.
>
> Do you believe the SEC or its chairman should take a position on whether or not commercial banks should be permitted to engage in the securities business?
>
> If Glass-Steagall is to be modified, would you agree that any major changes should be made by Congress and not regulatory agencies?
>
> What specific securities activities do you believe the commercial banking industry should be allowed to engage in? For example, should banks generally be permitted to underwrite corporate debt and equity securities?
>
> What regulation or safeguards, if any, would be appropriate or necessary, if banks were allowed to underwrite corporate equity?

I believe that the Commission should give Congress the benefit of the Commission's views as Congress considers how, or whether, to allow commercial banks to engage more fully in the securities underwriting business. The Commission has the best perspective on the risks, conflict of interest potential and structural problems that should be resolved prior to the time of any such Congressional action.

I strongly agree that modernization of Glass-Steagall should be accomplished by Congress. This is particularly important because regulatory modifications that would accompany any such change should be planned, not accidental.

I do not know of any aspects of the securities business that should be unlawful *per se* for banks. However, I do not believe that the Glass-Steagall Act should be modified until several related protections can be simultaneously adopted. First, most

new and preexisting securities activities of banks should be required to be conducted in a separate securities affiliate under the exclusive regulation of the Commission. Second, the Bank Holding Company Act should be amended to allow non-banking financial companies to acquire banks without becoming subject to that act. Third, specific protections against undue conflicts of interest and other abusive practices should be adopted. These reforms could be accomplished in a manner that would permit reduction in the barriers to competition without creating excessive risks or other significantly adverse effects. The Commission has previously taken a generally similar position with respect to modification of Glass-Steagall. In so doing, the Commission appropriately suggested that Congress:

- consider means to limit the improper sharing of confidential client information among units of a diversified financial services company;

- examine potential conflicts of interest arising out of bank underwriting activities of securitized assets and of securities of bank borrowers;

- examine the conflicts of interest arising in transactions between bank trust departments and affiliated entities;

- consider prohibitions on banks from extending or arranging credit secured by, or for the purpose of purchasing, any security that is underwritten by a bank's securities affiliate or in which the affiliate is an active participant; and

- examine the possibility of requiring disclosure statements clarifying a bank affiliate's separate status.

115. Lessons of the Thrift Crisis

Congress recently enacted the most far reaching government rescue program in our history. The financial problem in the savings and loan legislation is of enormous proportions -- the total cost to the government will far exceed the combined cost of the assistance provided to Lockheed, Chrysler, Penn Central, New York City and even the Marshall Plan.

There is no single culprit behind the thrift crisis. But we all know that a few factors -- such as the rush to deregulate, imprudent industry responses to deregulation and

inadequate supervision by regulators -- contributed substantially to the industry's decline.

With this in mind, what do you believe are the most important lessons we should learn from our recent experience with the savings and loan industry? Are there lessons we can apply to the current debate about the powers of commercial and investment banking?

Some of the lessons that I have learned from the disaster in the thrift industry include:

- Accounting principles play a vital role in allowing regulators, policymakers and others to judge the condition of a financial institution. Distorted accounting principles adopted for "regulatory" purposes other than full disclosure can cause deteriorating trends to remain unnoticed.

- Capital plays an essential role in providing discipline for financial institutions to deter against unwarranted risk-taking, especially by institutions with federal deposit insurance. Capital standards set by supervisors are essential to establish a minimum benchmark for prudent operations.

- Disclosure policies for insured institutions and their securities should be established by an agency <u>other than</u> the primary bank or thrift supervisory agency to insure that risks tolerated by supervisory authorities would be publicly disclosed.

- Supervisory authorities must be allowed to take appropriate enforcement action free of political pressures -- from Congress or an Administration. Institutions engaged in serious fraud or other wrongdoing must not think that they can obtain political relief from enforcement action.

- Delay in resolving problem situations of deteriorating financial condition and violation of regulatory standards often results in much larger ultimate losses than would have resulted from swift enforcement action.

The thrift experience has largely confirmed my prior views rather than changing them. I have always believed in strict enforcement of safety and soundness standards. Government regulation should seek to establish and to enforce minimum standards and rules of conduct, including capital, accounting, disclosure and other regulations necessary to prevent fraud,

manipulation or similar abusive practices. At the same time, market entry and exit, product offerings, pricing, locations for doing business, affiliations and other aspects of economic competition should be left to market forces as much as possible.

If anything, the thrift situation has also confirmed the absolute desirability of eliminating "regulatory" exceptions to the Securities Act and the Exchange Act, including the bank and thrift exemptions in Sections 3(a)(2) and 3(a)(5) of the Securities Act and the bank and thrift reporting provisions of Section 12(i) of the Exchange Act.

116. Globalization of Securities Markets

With the growing globalization of the securities markets, the SEC will face a number of important issues in the next few years -- from issues like international clearance and settlement to the potential standardization of securities regulation between nations. There is no question that these and other issues in the international arena will have a profound affect on the competitive position of the securities industry and our financial markets.

One of the most important issues involves continued access to international capital markets. In recent years we have witnessed a significant increase in the movement of capital without regard to geographic boundaries. Foreign offerings, euro-offerings, and multi-national offerings are established features of corporate finance and undoubtedly will become a more important source of capital for U.S. companies in the future.

What actions should the SEC take to enhance the ability of U.S. companies to raise capital in this emerging world market? Would a standardized system of disclosure for world-wide offerings create an environment to promote capital formation throughout the world?

In an increasingly competitive international market, some have questioned whether the U.S. can keep our financial markets both competitive and well policed at the same time. Do you share this point of view?

I do not believe that investor protection and international competitiveness are inconsistent. Investors around the world are concerned with the safety of their investments, which requires a "well-policed" system to prevent fraud, manipulation and other abuses. International competitiveness can be enhanced by flexibility in applying traditional standards and concepts, and in some areas by substantial streamlining of inefficient or unnecessary programs. However, stable and honest markets also can be a significant competitive advantage, and basic core protections of our system should be consistently applied.

Standardized disclosure, accounting and auditing standards would enhance the ability of U.S. companies to raise capital at the lowest cost in a worldwide market. They might also contribute to greater efficiency in global capital formation. Unfortunately, truly standardized disclosure, accounting and auditing standards may not be achievable over the near term. Substantially increased systems for multijurisdictional offerings, based on mutual recognition of established systems of securities regulation, offers the much more immediate prospect of achieving many of the same results as standardization. Mutual recognition would also eliminate many of the incentives for excluding U.S. shareholders from largely foreign offerings.

117. Foreign Investment

> In recent years, some, including several Members of Congress, have focused increased attention on the level of foreign investment in the United States. As foreign investment has increased, so has the interest to restrict foreign participation in our markets.
>
> In my view, some of the proposals to limit foreign investment are shortsighted and could work to damage our economy. It seems to me that access to capital -- regardless of its source -- is critical to American industry and continued economic growth.
>
> I would be interested in your thoughts on foreign investment in the U.S. and its impact on economic growth and job creation. At this time, do you see any reason to act to restrict foreign investment in the U.S.? What do you see happening if we act to restrict foreign investment in the U.S.? How would this impact American companies doing business abroad?

I share the view that having the widest possible access to both domestic and foreign capital promotes economic growth and job formation in the U.S. Restricting foreign investment in the U.S. would tend to increase the cost of capital in the U.S., thereby making U.S. companies less competitive internationally. Even trying to isolate the U.S. from global capital markets would cause enormous harm to U.S. financial markets, U.S. issuers of capital and their employees, and savers and investors in the U.S.

118. Economic Effects of LBOs

> The leveraged buyout has become one of the most talked about and perhaps least understood methods of financing a business. The sheer size of some recent transactions has focused attention on LBOs and, in some cases, distorted the public's perception of LBOs.
>
> In the wake of an avalanche of publicity about LBOs, some have advocated reforms, either in our tax laws or the securities laws. However, I think it's clear that a quick fix is not possible or practical.
>
> We know that an excessive reliance on leverage can create a number of problems for a company. But we also know that leverage can increase productivity and result in a more efficient use of resources, which increases our ability to compete in the international marketplace.
>
> Do you see any reasons to be concerned about the number or size of leveraged transactions in the economy? If so, what steps would you recommend to restrict LBOs?
>
> What can we do to more fully understand and track the impact of LBOs on the economy? Should the government, through the SEC or some other agency, be required to collect data on LBOs and their impact on employment, research and development, etc.

Initially, I would like to underscore your point, which is often overlooked, that leverage can have beneficial effects on a corporation's efficiency and competitiveness. When a corporation increases leverage, the corporation and its lenders review its ability to service its debt under all types of economic conditions. While some commentators argue that with increased leverage U.S. corporations will be unable to compete with Japan,

Japanese firms are significantly more levered on average than U.S. firms. Leverage also can strengthen managerial incentives to maximize earnings and value.

The increased leverage of American corporations is a matter that should be of concern, at least to the degree that we should understand the trends at work in our market and the factors affecting such trends. Rather than making policy based on anecdotal or isolated situations, we should track and carefully analyze empirical data regarding the nature and effects of such transactions over time.

I do not currently favor any steps to restrict LBO transactions as a class. However, regulators should carefully monitor the risk to banks, thrifts, insurance companies and other regulated lenders who finance LBOs. At the same time, the primary concern of the Commission should remain full and fair disclosure to protect individuals, in financial institutions and mutual funds that invest in noninvestment grade bonds.

119. As you know, after the October 1987 market break the Brady Commission recommended that one agency should coordinate regulatory issues which have an impact across related market segments. For example, in Japan and the U.K., one agency regulates both the traditional securities markets and the markets for derivative products.

What is your view on the separate SEC-CFTC jurisdiction over financial instruments? How do you believe the current regulatory structure in the United States impacts our competitive position in international markets?

I believe that Congress should decide the issue of separate SEC/CFTC jurisdiction. Many argue that unified regulatory jurisdiction over financial instruments would eliminate numerous regulatory disparities. However, regulatory differences often exist within a single "MOF"-style agency. In addition, a single agency is much more vulnerable to mistakes of judgment due to the absence of other senior-level regulators to act as a check and balance against unwise decisions.

Having two different agencies governing related products, even within a single broader market, does require the agencies to cooperate on common operational or supervisory issues. Comparison of the records of the thrift industry, with a single all-powerful regulator, and the commercial banking industry, with three separate agencies, does not suggest any inherent advantage from having a single regulator.

While having two different agencies need not prevent workable supervision and regulation, the lack of clarity as to jurisdictional authority does adversely affect U.S. competitiveness. This occurs due to both higher nonproductive overhead (to finance litigation), and also the disincentive to bringing new products to market that is caused by such uncertainty. Consequently, I believe that pending any broader action by Congress, the SEC and CFTC should try to develop mutually acceptable proposals to define product and jurisdictional lines. Most importantly, the "exclusivity" feature of the current Commodities Exchange Act needs to be repealed to permit efficient allocation of regulatory authority over particular products.

120. Individual Investor Confidence

> From all reports, it appears that individual investors have not been a large participant in the most recent market rally. In fact, the individual investor has remained on the sideline since the October 1987 market break. Meanwhile the markets have become increasingly institutionalized.
>
> How important is the individual investor to the markets and what specific measures, if any, do you believe should be initiated to restore investor confidence and bring the individual investor back into the markets?

In recent years, many individuals have made collective investments in securities through pension plans and mutual funds. However, individual investors in individual securities continue to play an important role in the nation's markets. Indeed, the most recent survey of stockholding by the NYSE, as of mid-1985, showed that more than 47 million Americans owned stock in a publicly-traded company or a stock mutual fund.

One of the most effective means to increase individual investor confidence and participation in the market is for the Commission and other regulatory agencies and self-regulatory organizations to enforce aggressively rules against insider trading, front-running, and other manipulative practices that compromise the integrity and fairness of the markets. In addition, tax policies that operate to disadvantage or discourage savings in general, or securities holdings in particular, should be reexamined. Finally, the industry needs to reexamine the convenience and cost of individuals acquiring or disposing stock, and the public's perception of the safety and prudence of investing.

121. Arbitration

> Do you believe that arbitration is an appropriate forum for settling disputes between a broker-dealer and a customer? Do you believe it is appropriate for a broker-dealer, as part of a new account agreement, to require a customer to agree to arbitration proceedings in the case of a dispute?

Arbitration can be an appropriate forum for settling disputes between a broker-dealer and a customer. Indeed, arbitration is an important alternative to litigation in many contexts, including alternative securities markets. However, the rules governing arbitration must be both fair, and perceived to be fair, to both broker-dealers and their customers.

Earlier this year the Commission approved a series of SRO rules designed (1) to improve the procedural fairness of SRO-sponsored arbitration, (2) to assure that investors received adequate notice of whether a contract contained an arbitration clause and of the basic differences between the resolution of disputes through arbitration vis-a-vis litigation, and (3) to prohibit agreements that limit or contradict the rules of any SRO or limit the ability of a party to file any claim in arbitration or the ability of arbitrators to make any awards.

122. Accounting

> The SEC has extensive regulatory and oversight responsibilities with respect to the accounting profession pursuant to the Securities Exchange Act of 1934.
>
> In the past few years, the House Energy and Commerce Committee has conducted a number of hearings concerning the effectiveness of the SEC's oversight responsibilities with respect to the accounting industry. One result of the hearings was the establishment of the Treadway Commission, which issued recommendations on ways to detect and deter financial fraud. As I understand it, many of the Treadway recommendations directed at the accounting profession have been implemented, including the adoption of a series of new auditing standards that clarify auditors' responsibility for detecting fraud.
>
> As you know, several mergers among the Big Eight accounting firms are pending. These developments are, in part, a response to the

> globalization of business and markets and the premium on competitiveness these new dynamics require. In addition, the profession is grappling with the difficult problem of increasing liability.
>
> With the above in mind, I am interested in learning what specific objectives and policies you want the SEC to accomplish with regard to the accounting profession.

The importance of full financial disclosure was recognized at the time the Securities Act was enacted, and its significance continues undiminished under our current integrated disclosure system. While primary responsibility for the provision of accurate, reliable and timely financial information rests with management (subject to oversight by the board of directors), independent accountants play an important role in assuring that honest information concerning their clients reaches the public.

The object of the Commission's accounting program is to ensure compliance with the accounting and financial disclosure aspects of the federal securities laws. This program is carried out through four closely-related activities that result in an active and visible presence in the accounting area: (1) the review and comment process; (2) the enforcement program; (3) the oversight of private standard-setting; and (4) rulemaking. The Commission's oversight of accounting practices and standards is a key element in maintaining the full disclosure system and in assuring that public investors receive useful, reliable information.

123. Commission Vacancies

> Several other vacancies are likely to be filled on the Commission in the near future. Do you expect to be in the position to advise the President with respect to candidates for vacancies on the Commission? If so, what criteria will you employ in making your recommendations to the President?

Yes, I expect to have a voice in the selection of candidates for vacancies on the Commission. I would recommend persons with the best possible combination of intelligence, public and private experience, judgment and character in filling these positions.

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X. Questions from Senator John Heinz

124. On August 18th, the United States Court of Appeals for the Seventh Circuit in Chicago Mercantile Exchange v. SEC set aside SEC orders approving the applications of three securities exchanges to trade index participations. The Court held that if an instrument is both a security and a futures contract then the CFTC has exclusive jurisdiction over the instrument.

a. The Seventh Circuit panel viewed this case as a repeat of the jurisdictional dispute between the SEC and CFTC that occurred in 1981 over the trading of options on Ginnie Maes and predicted that with the inevitable creation of novel instruments with attributes of both securities and futures "[o]nly merger of the agencies or functional separation in the statute can avoid continual conflict." Do you agree with this prognosis?

Since this case is still on appeal, I do not think it appropriate to concede the validity of the decision of the panel regarding the scope of the exclusivity provision in the Commodity Exchange Act. This is especially true given the SEC Savings Clause in that legislation, and the longstanding intent of Congress that the SEC should have jurisdiction over securities instruments broadly defined.

Products that are not largely or exclusively futures products should not, in my opinion, be subject to exclusive jurisdiction of the CFTC or a requirement that they be traded on a futures exchange. For example, a hybrid product with characteristics that were 99% those of a security and 1% "futurity" should not trigger exclusive CFTC jurisdiction.

I believe that it may prove useful, in light of this decision, for Congress to clarify the jurisdictional lines between the agencies. Ideally any legislation would be based on recommendations by the Commission and the CFTC. Any such clarification should eliminate the exclusivity provisions of the Commodity Exchange Act, at least as to all products that could be deemed to be a security. Just as banking products may be regulated by any one of three different federal agencies, there is not any conceptual reason why a financial product with some element of futures characteristics could not be traded or regulated through either a securities or futures exchange.

125. b. Assuming solely for arguments sake that the court's reading of the Commodities Exchange Act is correct that the CFTC has exclusive jurisdiction over all instruments that have attributes of both securities and futures, do you agree with the court's observation that "if both categories [of securities and futures] expand, then the SEC's jurisdiction shrinks"? If so, what are the regulatory and market implications?

If the court is correct that the CFTC possesses exclusive jurisdiction even where a trivial portion of a product's overall characteristics involve some degree of futurity, then there would be highly negative implications for both the Commission and overall market regulation. In essence, the Commission's jurisdiction would shrink steadily, probably together with that of the bank regulatory agencies.

Over time, if hybrid products become more common, the CFTC's role would expand well beyond its current scope, as would be true with the futures exchanges as well. Finally, the development of new securities products would be inhibited due to the risk that any new product subsequently might be found to be "tainted" with some element of "futurity."

Several innovative products, such as swaps and commodity-backed bonds, cannot as a practical matter be traded and cleared through futures markets and associated clearinghouses due to certain inherent characteristics of such systems. In my opinion, this interpretation of the law could stifle innovation, and reduce the overall competitiveness of U.S. securities markets internationally in a manner that was never considered or intended by Congress.

126. c. The Seventh Circuit panel acknowledged that its decision did not reflect a value judgment as to which agency was best equipped to regulate index participations. In your judgment, which agency is best able to regulate this product, and why?

As the Commission discussed in its order approving the exchange proposals to trade index participations (IPs) and indicated in its Petition for Rehearing in this case, the securities markets may be better suited for IPs trading than the futures markets. IPs were designed as a product to appeal to retail investors, who, as a rule, participate less frequently in the futures markets. In addition, many potential IPs investors may be effectively prohibited from participating in the futures markets as a result of regulatory constraints or contractual provisions.

127. d. In your view, should the inventors of innovative hybrid products such as index participations be able to decide which exchange is best suited to its product? Does it make a difference in which exchange or under which set of rules or regulations hybrid products are traded? If so, why?

I do not believe that the exchanges that developed these new products should be denied the legal right to compete with futures exchanges by offering this product to their customers. Indeed, under the 1982 SEC-CFTC Jurisdictional Accord, the SEC has jurisdiction over options on foreign currency if they are traded on national securities exchanges, and the CFTC has jurisdiction over such options if they are not traded on a securities exchange. This is a similar process to that in effect for all banks or thrift institutions, which are regulated based on the type of charter each firm selects.

The Commission has stated on several occasions that the regulatory and market structures under which a product is traded can make a difference. For example, due in part to the separate clearing systems utilized by each futures exchange, trading on a futures exchange would reduce the possibility of competition in any such product among various exchanges. Similarly, the retail orientation of the securities markets may be better suited for a product like IPs than the more institutional character of the futures market. Finally, futures regulation may create difficulties for many types of hybrid instruments.

An example of the latter type of problem is the case of debt instruments with returns linked to the movement of a stock index, foreign currency, precious metal, or oil. This has been the most common type of hybrid instrument in the U.S. capital markets to date. Requiring those instruments to trade exclusively on a board of trade would have constituted a serious obstacle to the development of these products. The exclusivity requirement would remove these products from the over-the-counter market, where most corporate debt instruments trade. This could discourage their purchase by persons or institutions who either choose not to trade in the futures markets, or are prohibited from doing so. Futures market regulation also is not designed to focus on disclosures relating to particular issuers, information that is particularly important for this type of hybrid instrument.

Rather than courts or agencies deciding the exchange on which new hybrid financial products must be traded, it would be better to leave that decision to the private market. For example, one possible approach to the jurisdictional issue would allocate jurisdiction based on whether a hybrid product is

accepted for trading on a securities or futures exchange. In either case, the SEC or CFTC, respectively, would apply its normal regulatory oversight and the same rules that it applies to other instruments traded on the same exchange. In this manner, the public would be guaranteed all of the protections associated with products traded on the same exchange, yet innovation would be protected and unnecessary litigation avoided.

128. On May 25, 1989, the SEC adopted Rule 19c-5 under the Securities Exchange Act to prohibit any options exchange from restricting the listing of any new stock options class to a single exchange. The rule repeals the Allocation Plan for exchange listed options approved by the SEC in 1980 and eliminates all restrictions on the multiple trading of options.

a. At the time restrictions on the multiple trading of exchange listed options were approved by the SEC in 1980, the Commission contemplated the development of a market integration system that would alleviate many of the market structure and investor protection concerns (e.g., market fragmentation, trade-throughs and order routing practices) posed by the multiple trading of options. In approving Rule 19c-5, the SEC stated that "there are sound reasons for pursuing the development of market integration facilities." Do you agree? If so, what role should the SEC play in facilitating the development of an integration system?

Yes, I agree that market integration facilities would be useful. The SEC should maintain an oversight role, since it would have to approve any exchange proposals regarding integration systems. However, the private sector should select and design specific market integration facilities, if any. The Commission should only take direct action through rulemaking if divisions among the options exchanges make the development of needed market integration facilities otherwise impossible.

129. b. If integration facilities are feasible and cost beneficial, are there advantages to having all options exchanges joined by the linkage system?

Yes, although there may also be costs or disadvantages.

130. c. Following the adoption of Rule 19c-5, certain of the options exchanges initiated a study to determine the feasibility of developing market integration facilities. These exchanges have expressed concern that implementation of multiple trading pending completion of this study and the development of integration facilities may be counterproductive. Should the SEC consider the deferral of Rule 19c-5 if the development of integration facilities appears imminent?

Yes, I believe the Commission should consider deferral if implementation of integration facilities was imminent, although I cannot commit the other Commissioners to this position.

131. The recent controversy surrounding Sir James Goldsmith's tender offer for British American Tobacco (B.A.T.) has brought into focus the question of the extraterritorial application of U.S. securities laws. The transaction was apparently structured to avoid the jurisdiction of the federal securities laws, purportedly because compliance with our laws was viewed as both costly and time-consuming. As a result, U.S. shareholders of B.A.T. have been excluded from participating in the offer.

a. How do you reconcile the fact that laws designed to protect U.S. investors may have the effect of depriving these investors of participation in offers made to non-U.S. shareholders?

b. How should the SEC balance its mandate to protect U.S. investors with the goal of fostering an international securities market?

c. When should the federal securities laws apply to transnational securities transactions? In other words, where should the jurisdictional lines be drawn?

The increasing internationalization of securities transactions and markets may be the single greatest factor affecting the Commission in the years ahead. Issuers will increasingly offer securities in a variety of markets. In this environment, U.S. investors and markets could be disadvantaged seriously if foreign or U.S. issuers choose to eschew U.S. markets due to the costs and delays associated with complying with U.S. law.

If confirmed, I will encourage the Commission to explore ways to remove U.S. regulatory disincentives for extending offers to U.S. holders on equal terms with those of other shareholders, where the home country's regulatory scheme is adequate to protect the interest of investors and the percentage of shares held by U.S. persons is limited. However, deferral to other registration or disclosure systems would not extend to eliminating jurisdiction with respect to fraudulent conduct that adversely affects U.S. persons, which should be retained.

The Commission has proposed a limited multijurisdictional system for disclosure with respect to rights offerings and cash and exchange tender offers involving Canadian companies. This proposal is an attempt to respond to the realities of our international capital markets in a positive and constructive manner.

In addition to mutual recognition systems for offerings, the Commission needs to be sensitive to the impact of international differences in accounting standards. While core U.S. standards should not be weakened solely due to international differences, the Commission must be prepared to reexamine past practices to avoid any unnecessary disadvantage for U.S. firms, markets or investors.

132. The SEC has under consideration recommendations to revise Rule 13e-3 regarding "going private transactions." The recommendations include broadening the scope of the rule to require disclosures in all negotiated transactions, not just those initiated by an unaffiliated third party. This revision is intended to address the concern that management is at times on both sides of an LBO transaction, whether directly as part of the buyout group, or indirectly, as a potential recipient of an offer to participate in the transaction.

Do you support broadening the scope of Rule 13e-3 in this manner?

The Division of Corporation Finance is preparing a rulemaking proposal for Commission consideration that would amend the transactional disclosure requirements to enhance shareholder analysis of extraordinary corporate control transactions recommended or approved by the board of directors. The proposals would amend Rule 13e-3 to ensure that its disclosure requirements reach all going private transactions in which management has a significant interest. The proposals also would impose a new set of disclosure requirements upon issuers engaged in all negotiated

extraordinary corporate transactions affecting control of the company, such as mergers, acquisitions and sales of assets, as well as certain issuer tender offers and buybacks, recapitalizations and reorganizations. The proposals would require a detailed description of the factors supporting the target company's recommendation or approval of the transaction to its security holders, including information about the board's evaluative processes and the intrinsic values of the transaction and the target company.

While I generally agree with the goals of the staff's proposals, I have not had the opportunity to study the proposals in detail. Therefore, I must reserve judgment as to whether I would support them if presented to the Commission.

133. Is disclosure sufficient to address actual or perceived conflicts of interests of management or are substantive rules warranted?

The Commission previously rejected a substantive fairness concept in Rule 13e-3 transactions in light of opposition by commentators, the implication of the Supreme Court decision in Santa Fe Industries v. Green, and the potential administrative problems of such a requirement. The Commission instead decided to leave the substantive law of fairness to the states and to require certain disclosures to allow security holders to view the transaction from management's perspective including the purpose of the transaction, the alternatives considered, and the advantages and disadvantages to all parties.

The concept of fairness under state law historically has recognized fairness as a range and has recognized that a "fair price" is not necessarily the highest price currently obtainable. This historic view of fairness may reflect in part the inexact nature of modern valuation techniques and the difficulty in predicting the highest currently obtainable price, particularly in a highly active market environment.

Recent case law suggests a change in this historic view and may require fairness to reflect the highest price currently obtainable. Moreover, experience has shown that state courts will entertain legal challenges to the fairness of going private transactions and will provide shareholders with the appropriate legal remedies.

As indicated in the release adopting Rule 13e-3, the Commission continues to monitor developments in this area and the efficacy of the rule. The Commission vigorously enforces the existing disclosure requirements of the rule by improving disclosure through the comment process and when necessary instituting enforcement actions.

134. Rule 13e-3 currently requires disclosure of the "fairness" of transactions to shareholders. Are subjective concepts such as fairness meaningful in the context of disclosure or would comprehensive disclosure of more objective data relating to value of the company (e.g. break-up value) be more helpful to shareholders attempting to analyze the merits of the offer.

The Commission's disclosure requirements currently are designed to elicit objective information to allow shareholders to make an independent assessment of the fairness of the transaction and the adequacy of the consideration. For example, Item 8 of Schedule 13E-3 requires that the issuer and any affiliate engaged in the transaction not only state whether each reasonably believes that the transaction is fair to unaffiliated shareholders, but also that such party discuss the factors (including liquidation value) and weight to be given the factors important to determining fairness. This would include the analysis and conclusions with respect to each factor, as conclusory statements are not considered sufficient disclosure.

In connection with the proposals to amend Rule 13e-3, I understand that the staff is currently considering ways to develop a more comprehensive list of factors normally considered in these transactions. If confirmed, I would inquire thoroughly into these issues.

XI. Questions from Senator Alfonse M. D'Amato

135. Glass-Steagall

> Is it your impression that the thrift legislation has taken us closer to, or farther from, a consensus on Glass-Steagall reform?

It does not appear that the process of enacting the thrift legislation has affected the level of support for repeal of the Glass-Steagall Act. The thrift crisis does, however, illustrate the need to accompany any revision of Glass-Steagall with adequate supervision of any new securities powers given to banking organizations. Reform of the regulatory structure must be an integral part of any change in "powers," not simply an after thought.

136. Glass-Steagall

> The Cranston-D'Amato-Garn approach to financial services reform gives all companies the opportunity to get into the banking business and the securities business providing they meet the stringent firewall, functional regulation and other requirements: Do you agree or disagree with the breadth of this approach?

I generally support a broad approach to reform that considers powers, conflicts of interest, regulatory structure and stability concerns simultaneously. It would be particularly unwise to commence full-scale activities in securities markets without making necessary revisions in the regulatory structure at the same time.

XII. Questions from Senator Christopher S. Bond

137. Should U.S. securities laws apply to a takeover battle between two foreign companies if there are substantial U.S. holdings of one of the companies?

The presence of assets in the U.S. owned by a foreign issuer of securities, without any other jurisdictional nexus, has never been sufficient to create jurisdiction under U.S. securities laws over such issuer or its securities outside the U.S. This traditional legal standard recognizes the practical limits of extraterritorial application of U.S. law, as well as principles of international comity.

138. We have a system of country-by-country securities regulation which in many ways is not compatible with global financial markets. How can our regulatory structure be updated to reflect the realities of truly international financial markets? How can we avoid a competition in laxity as countries compete to attract securities business?

Increased regulatory coordination and mutual recognition of home country securities laws can increase the efficiency of the global capital markets, while assuring investor protection. Under such a system, an American prospectus could be used, for example, to offer securities simultaneously in the U.S., Canada, U.K. and Japan. Similarly, in certain types of situations a U.K. disclosure document would be recognized in the U.S. and other countries.

Similarly, coordination and accommodation of legitimate, ordinary course foreign market practices will most likely prove to be the most practical and timely means of addressing differences in stabilization and other distribution regulations among jurisdictions.

The alternative to a "mutual recognition" system would be the development of common international standards. Such standards could cover matters such as disclosure requirements, accounting principles, and audit standards.

Fortunately, these two approaches are not mutually exclusive. The Commission should continue to work with the International Accounting Standards Committee and the International Federation of Accountants to develop acceptable uniform international accounting principles, auditing standards, and auditor independence standards. Such international

standards, accepted as assuring sufficiently reliable and relevant disclosure, would greatly reduce issuers' costs, provide investors with adequate and comparable financial information and would not unduly disadvantage U.S. issuers in the U.S. market. However, development of such standards will almost certainly require a long-term effort, because of the substantial variation among jurisdictions.

Despite increased competition between the world's securities markets, a "race to the bottom" must be avoided. Notwithstanding the desirability of facilitating international markets, the U.S. should continue to insist on core protections for U.S. markets and investors. At the same time, the Commission must seek to encourage its foreign counterparts to move toward standards that would reduce the costs or disadvantages to firms adhering to U.S. standards.

139. The philosophical basis of our securities laws is full disclosure to investors and neutrality between bidders and targets. Are these principles still valid in this new global environment?

Yes. I continue to believe that full disclosure and neutrality best serve the interest of shareholders. If anything, more complex and widespread investment opportunities on a transnational basis make it more important to allow each investor to make independent investment decisions based on full and fair disclosure and personal choice.

140. The North American Securities Administrators Association has estimated that U.S. consumers are robbed of two billion dollars a year by penny stock swindles. In testimony before the Energy and Commerce Committee, the Utah securities commissioner stated, "With very few exceptions, the non-NASDAQ over the counter penny stock market no longer fulfills its traditional role as the cradle for America's new start up companies and expanding firms. Instead the penny stock market has been flooded with spurious and insubstantial schemes dreamed up by profiteering brokerage firms and behind the scenes manipulators, who include chronic securities law violators, convicted felons and organized crime figures." Do you agree that the problem with penny stock fraud is this serious?

I do not have any independent information concerning the extent of this problem. Penny stock fraud is a very serious

matter. The number of complaints from investors has risen sharply, and the number of enforcement referrals from broker-dealer examinations has also risen sharply. Investors who are defrauded in penny stock manipulations, and others who learn of such abuses, may lose confidence in the securities market and not invest in legitimate small businesses. This hurts the capital-raising efforts of small companies and, consequently, the nation's economy.

If confirmed, I will strongly support efforts to attack this problem. Penny stock fraud manipulators will be vigorously prosecuted, and I will support legislation giving the Commission authority to impose fines upon persons who violate the federal securities laws. Finally, the Commission should continue to explore regulatory initiatives that can improve protection for penny stock investors.

141. SLERA

> Does the SEC need additional legal authority to go after this fraud? Are the additional powers in S. 647 sufficient? How do we go after the chronic securities law violators who are not deterred by civil fines?

The Commission has requested additional enforcement authority to prosecute penny stock fraud and other serious securities law violations. The sanctions proposed in S. 647 are intended to enhance the Commission's enforcement ability in several important respects. For example, by altering the economic consequences of the violations, the addition of the penalties provided by the bill to the Commission's enforcement arsenal should deter those who would commit securities law violations for financial gain. These penalties also should deter persons who violate the securities laws in spite of the prior imposition of other remedies against them for the same or similar conduct. A money penalty should give the courts and the Commission greater flexibility to tailor a remedy to the gravity of the violation.

Criminal prosecution often would be available with respect to chronic securities law violators who are not deterred by civil fines. In the past, the Commission has often determined that many enforcement actions it brought did not warrant criminal prosecution. However, in areas of widespread abuse, criminal fines and imprisonment may be necessary to restore a climate of deterrence, and respect for the law.

XII. Questions from Senator Connie Mack

142. PUHCA

Are you generally familiar with the Public Utility Holding Company Act of 1935 (the "1935 Act") and the Commission's duties thereunder?

Yes.

143. Are you aware of the Commission's prior recommendation that the Act be repealed?

Yes. For many years the Commission has supported legislation to repeal the 1935 Act, or at a minimum to transfer the Commission's responsibilities to another agency. Support for repeal of the 1935 Act is not universal. Different utility companies have both supported and opposed efforts to repeal the statute. In addition, certain consumer-oriented groups have opposed repeal of the statute.

144. We assume you are aware that the Bush Task Force on Regulatory Relief recommended that the Act be repealed. Do you concur in that recommendation?

Yes.

145. Are you familiar with proposed Rule 17 under the Act?

Do you favor the adoption of that or a similar rule relating to diversification by exempt utility holding companies? If so, would you explain why?

I am generally aware of the provisions of proposed Rule 17, but I have not reviewed it in detail. I continue to support an outright repeal of the Public Utility Holding Company Act, or at a minimum transfer of responsibilities to a more appropriate agency. If the statute is not repealed, the Commission must attempt to enforce its provisions in a sensible and efficient manner. Proposed Rule 17 includes artificial percentage limitations on non-utility businesses that are not set forth in the statute. Such artificial restraints on competition should be intensely scrutinized to determine whether they are absolutely necessary to achieve statutory purposes.

146. Are you familiar with the "Casey/Loomis" guidelines concerning diversification by exempt utility holding companies set forth in the 1973 Pacific Lighting case?

The "Casey/Loomis Guidelines" were standards articulated by these two commissioners concerning investments by exempt holding companies in non-utility businesses.

147. Do you believe that those guidelines should still be applied by the Commission? If not, do you favor any revision of those guidelines or should they be abandoned altogether?

I do not currently have a view concerning whether these guidelines should continue to be applied. This issue will, of course, be part of the Commission's rulemaking proceeding as it considers Rule 17. Therefore, I would give close attention to this question, and all public comments, at that time.

XIII. Questions from Senator William V. Roth, Jr.

148. What is your general philosophy regarding hostile takeovers, LBO's and MBO's. Do you believe there are some rules governing the marketplace that should be changed? If so, which?

As set forth in the Williams Act, federal law has long sought to protect shareholder rights in corporate control contests. These include full disclosure of information shareholders need to make an informed investment decision, and procedures necessary to create an environment conducive to a sound investment decision (minimum offering period, price adjustments, proration, and withdrawal rights).

Federal law requires disclosure by both those seeking securities through a tender offer, and those who are accumulating shares through other means once their holdings exceed a 5% threshold. Finally, it penalizes fraud, manipulation and other abusive practices. Thus, federal law establishes a neutral policy -- sometimes characterized as "a level playing field" -- whose objective is full disclosure to shareholders and protection of their ultimate ownership rights.

I generally believe that the federal policy set forth in the Williams Act is correct. It is also extremely important to maintain an integrated national securities market that will facilitate the raising of capital and enable U.S. markets to remain internationally competitive.

If confirmed, I intend that the Commission will continue to monitor its disclosure requirements to ensure that security holders are adequately protected. Thus, the Commission is presently examining the adequacy of its disclosure requirements with respect to management buyouts and other negotiated transactions, as well as disclosure to debt holders. I would support proposals to close the so-called "13(d) window," such as by reducing the filing period to five business days, with an automatic standstill in purchases until a filing is made.

149. Are you concerned by the level of debt involved in LBOs? Are you concerned by financial institutions holding such debt? If so, how would you address these concerns?

Yes, I am concerned about the degree of leverage of certain issuers of securities, as well as the issue of overall debt levels. Ultimately I believe that the current tax provisions that penalize the use of equity capital by U.S. corporations

should be altered, as this imbalance is a factor in many transactions in which debt financing is used to buy out shareholders' equity.

150. The current effort of Hoylake to take over B.A.T. raises the question of what mechanism should there be to govern transactions with multinational aspects. As a matter of policy, in such a situation should U.S. shareholders receive the protections of U.S. law, British law, or none at all? What are your thoughts jurisdictionally regarding this type of takeover?

The staff of the Commission has determined that the Commission does not have regulatory jurisdiction under U.S. law over the B.A.T. offer. The Commission cannot act where it does not have regulatory jurisdiction. Of course, antifraud liability might apply if the offer were to effect a fraud on investors in the U.S.

Unfortunately, U.S. investors are often prevented from participating in rights offerings by foreign firms and tender and exchange offers for foreign firms, because of the costs and delays associated with complying with U.S. law, even where the percentage of shares held by U.S. persons is insubstantial. I support efforts to find ways to remove U.S. regulatory disincentives for extending offers to U.S. holders on equal terms with those of other shareholders, where the home country's regulatory scheme is adequate to protect the interest of investors and the percentage of shares held by U.S. persons is limited. Of course, jurisdiction over fraudulent conduct that adversely affects U.S. persons should be retained.

151. Do you believe that our securities laws are a bit dated? If so, what general problems are not adequately addressed by current law?

Yes, I believe our basic financial services laws, including the securities laws, would benefit from modernization. Current law often excessively restricts competition, which is critical to maintaining U.S. efficiency and competitiveness in a global marketplace. Improvements in the regulatory structure itself should also be made to improve our ability to maintain the integrity and stability of the markets and to achieve greater consistency in regulation.

152. What do you believe to be the role of the SEC in improving our competitiveness as a nation?

The SEC can contribute to improving the nation's competitiveness by continuing to ensure the integrity of the

markets through enforcement and regulatory initiatives. Ensuring the honesty and fairness of the securities markets encourages participation of investors in the market, thereby promoting capital formation. The Commission must also continue to eliminate unnecessary regulation that increases the costs to issuers of raising capital in the U.S. Finally, the Commission should continue to encourage foreign securities authorities to allow U.S. issuers and market participants greater access foreign markets. Taken together, these steps to encourage savings and investment and to reduce the cost of capital can positively affect growth, employment and prosperity of the U.S.

153. Glass-Steagall Repeal

> Should banks be allowed to own securities firms and vice versa? Should Glass-Steagall be repealed?

The Commission has supported repeal of the Glass-Steagall Act, so long as repeal is accompanied by the requirement that banks conduct most of their new and existing securities activities in separate securities affiliates or subsidiaries subject to Commission regulation.

The Commission has also stated that securities firms should be permitted to engage in the full range of banking activities, subject to banking regulation. I agree with the Commission's basic position. However, I do not believe that the Glass-Steagall Act should be repealed unless the Bank Holding Company Act is also substantially amended to make it possible for firms that are not predominantly engaged in banking to own a bank without being regulated as a bank holding company. In addition, other appropriate reforms of regulatory structure and conflict of interest provisions would have to be enacted simultaneously.

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XIV. Questions from Senator Nancy L. Kassebaum

154. We are rapidly entering a market where financial instruments will have both securities and futures features. I am concerned that our present regulatory structure is not designed to regulate such hybrid instruments. Such regulation, however, must not fall through the cracks. Do you have any ideas as to how the SEC and CFTC can better coordinate the regulation of such instruments?

Yes, I believe that there are several areas in which the SEC and CFTC may improve supervision over hybrid financial instruments. One important reform would be the repeal of the exclusivity provisions of the Commodity Exchange Act ~~so that there will not be~~ to eliminate a legal impediment to joint regulation of hybrid products. Products that are not largely or exclusively futures products should not, in my opinion, be subject to exclusive jurisdiction of the CFTC or a requirement that they be traded on a futures exchange.

For example, a hybrid product with characteristics that were 99% those of a security and 1% "futurity" should not trigger exclusive CFTC jurisdiction. Just as banking products may be regulated by any one of three different federal agencies, there is not any conceptual reason why a financial product with some element of futures characteristics could not be traded or regulated through either a securities or futures exchange.

In a recent decision, the Seventh Circuit held that the CFTC possesses exclusive jurisdiction, even where a trivial portion of a product's overall characteristics involve some degree of futurity.

If upheld, or not altered by legislation, this decision could have highly negative implications for both the Commission and overall market regulation. In essence, the Commission's jurisdiction would shrink steadily, probably together with that of the bank regulatory agencies. Over time, if hybrid products become more common, the CFTC's role would expand well beyond its current scope, as would be true with the futures exchanges as well. Finally, the development of new securities products would be inhibited due to the risk that any new product subsequently might be found to be "tainted" with some element of "futurity."

Several innovative products, such as swaps and commodity-backed bonds, cannot as a practical matter be traded and cleared through futures markets and associated clearinghouses due to certain inherent characteristics of such systems. In my opinion, the continuation of this exclusivity could stifle innovation, and reduce the overall competitiveness of U.S. securities markets internationally.

XV. Questions from Senator Larry Pressler

155. Many of us, as you know, are very much concerned over the proliferation of highly leveraged buyouts. I am concerned with the threat to our economy posed by the massive build-up of corporate debt. I am equally concerned with the loss of tax dollars as a consequence of these transactions. Today, however, I would appreciate getting your thinking on offshore LBOs that affect the interests of U.S. investors.

Specifically, I refer to the hostile bid of Hoylake Investments Limited (controlled by Sir James Goldsmith and his partners) to acquire all of the stock of B.A.T. Industries in a highly leveraged transaction involving $6 billion in dollar-denominated junk bonds that are likely to "come to rest in the United States." The SEC response has been that it lacks jurisdiction to apply the Securities Act registration requirements in this situation. What do you think can or should be done to assert the SEC's jurisdiction to protect U.S. investors and interests when a hostile offer such as this is structured to avoid the reach of U.S. securities laws?

Foreign issuers making an exchange offer of this kind frequently do not extend offers to U.S. holders because they are unwilling to bear the costs and other burdens of registering securities in the United States. The U.S. securities laws and the principles of international comity would not permit the Commission to require a foreign issuer to enter the U.S. securities markets against its will, even though U.S. investors may be excluded from investment opportunities. Foreign citizens and corporations are free to decline to do business in this country, exactly as some U.S. companies choose (or are ordered) to avoid doing business in certain foreign countries.

The B.A.T. transaction demonstrates the benefits of lifting U.S. regulatory disincentives for extending offers to U.S. holders on equal terms with those of other shareholders, where the home country's regulatory scheme adequately protects the interest of investors and the percentage of shares held by U.S. persons is limited. At the same time, jurisdiction over fraudulent conduct that has an effect on U.S. persons should be retained.

With respect to your concern that dollar-denominated securities will come to rest in the United States, the Commission has obtained a great deal of experience in applying its securities registration requirements to offerings of securities overseas. It is not unusual even for U.S. issuers to offer dollar-denominated securities overseas without compliance with U.S. registration requirements where there are adequate assurances that the securities will come to rest outside the U.S.

I do not have any independent knowledge of factors that would suggest that the securities in question would come to rest in the U.S. Therefore, I do not have any present basis for determining whether this transaction is structured in a manner intended to violate U.S. laws.